STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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May 21, 2007

Dear Interested Party:

Enclosed are the Agenda, Issue Paper, and Revenue Estimate for the May 31, 2007 Business Taxes Committee meeting. This meeting will address proposed amendments to Regulation 1803, *Application of Tax,* and conforming amendments to Regulation 1802, *Place of Sale and Use for Purposes of Bradley-Burns Uniform Sales and Use Taxes.*

If you are interested in other topics to be considered by the Business Taxes Committee, you may refer to the "Business Taxes Committee" page on the Board's Internet web site (http://www.boe.ca.gov/meetings/btcommittee.htm) for copies of Committee discussion or issue papers, minutes, a procedures manual, and a materials preparation and review schedule arranged according to subject matter and meeting date.

Thank you for your input on these issues and I look forward to seeing you at the Business Taxes Committee meeting at **9:30 a.m.** on **May 31, 2007,** in Room 121 at the address shown above.

Sincerely,

Randie L. Henry, Deputy Director
Sales and Use Tax Department

RLH: lrc

Enclosures

cc: (all with enclosures)
Honorable Betty T. Yee, Chairwoman, First District (MIC 71)
Honorable Judy Chu, Ph.D., Vice Chair, Fourth District
Honorable Bill Leonard, Member, Second District (MIC 78)
Honorable Michelle Steel, Member, Third District
Honorable John Chiang, State Controller, C/O Ms. Marcy Jo Mandel (via e-mail)

Mr. Alan LoFaso, Board Member's Office, First District (via e-mail)
Mr. Mark Ibele, Board Member's Office, First District (via e-mail)
Mr. Steve Shea, Board Member's Office *(3 copies)*, Fourth District (via e-mail)
Ms. Margaret Pennington, Board Member's Office, Second District (via e-mail)
Mr. Lee Williams, Board Member's Office, Second District (MIC 78 and via e-mail)
Mr. Ken Maddox, Board Member's Office, Third District (via e-mail)
Mr. Neil Shah, Board Member's Office, Third District (via e-mail)
Ms. Melanie Darling, State Controller's Office (via e-mail)
Mr. Ramon J. Hirsig (MIC 73)
Ms. Kristine Cazadd (MIC 83)
Mr. Robert Lambert (MIC 82)
Mr. Randy Ferris (MIC 82)
Ms. Carole Ruwart (MIC 82)
Mr. Cary Huxsoll (MIC 82)
Ms. Janice Thurston (via e-mail)
Ms. Jean Ogrod (via e-mail)
Mr. Jeff Vest (via e-mail)
Mr. David Levine (MIC 85)
Mr. Steve Ryan (MIC 85)
Mr. Rey Obligacion (via e-mail)
Mr. Todd Gilman (MIC 70)
Mr. Dave Hayes (MIC 67)
Ms. Freda Orendt (via e-mail)
Mr. Stephen Rudd (via e-mail)
Mr. Joseph Young (via e-mail)
Mr. Jeffrey L. McGuire (MIC 92 and via e-mail)
Mr. Vic Anderson (MIC 44 and via e-mail)
Mr. Geoffrey E. Lyle (MIC 50)
Ms. Leila Khabbaz (MIC 50)
Ms. Lynda Cardwell (MIC 50)
Mr. Chuck Arana (MIC 50)

AGENDA — May 31, 2007 Business Taxes Committee Meeting

*Proposed Amendments to Regulation 1803, A*pplication of Tax

Action 1 – Application of local sales and use tax	Approve one of the following alternatives:
Issue Paper Alternative 1 – Staff Recommendation, supported by the California Retailers Association, HdL Companies, Mr. Douglas R. Boyd, California State Association of Counties, Orange County and the Cities of Corning, Lake Forest, Encinitas, Mountain View, San Marcos, and Paso Robles.	Do not amend Regulations 1803 or 1802. **OR**
Issue Paper Alternative 2 – Proposed by MuniServices LLC (MSLLC), supported by the Cities of San Ramon, San Diego, San Bernardino, Long Beach, Los Angeles, Sacramento, and Mr. Robert E. Cendejas representing the City of Ontario.	Approve and authorize for publication the proposed amendments to Regulations 1803 and 1802, on a retroactive basis, to: Regulation 1803, subdivisions (a)(1), (b)(1), and (d): • Provide that sales of property delivered into California, with title transferring outside the state, are subject to local sales tax when there is participation in the sale by the out-of-state retailer's local office, even though state use tax applies. • Remove the requirement that the local tax must follow the state tax. • Provide that lease transactions are not affected by the amendment. Regulation 1802, subdivisions (a)(2)(b) and (a)(3): ▪ Define "participation" for the purposes of Regulation 1803. ▪ Remove any reference to title passing outside the state. **OR**
Issue Paper Alternative 3 – Proposed by the City of San Jose, supported by the League of California Cities.	Approve and authorize for publication the proposed amendments to Regulations 1803 and 1802, on a prospective basis, to: Regulation 1803 (a)(1), (a)(2), and (b): ▪ Provide that sales of property delivered into California, with title transferring outside the state, are subject to local sales tax when there is participation in the sale by the out-of-state retailer's local office, even though state use tax applies. ▪ Remove the requirement that the local tax must follow the state tax. ▪ Provide that lease transactions are not affected by the amendment. ▪ Define local participation and the place of business of the retailer for the purposes of determining whether local sales or use tax applies. Regulation 1802, subdivision (a)(3): • Remove any reference to title passing outside the state.

AGENDA — May 31, 2007 Business Taxes Committee Meeting
Proposed Amendments to Regulation 1803, Application of Tax

Action Item	Regulatory Language Proposed by MSLLC	Regulatory Language Proposed by San Jose
Action 1 -		
Proposed amendments to Regulation 1803 (a)	(a) SALES TAX (1) IN GENERAL. Except as stated below, in any case in which state sales tax is applicable, state-administered Bradley-Burns uniform local sales tax is also applicable, if the place of sale is in a county imposing a state-administered local tax. ~~In any case in which state sales tax is inapplicable, state-administered local sales tax is also inapplicable. Thus,~~ If the place of sale as defined in Regulation 1802 is in a county having a state-administered local tax, the local sales tax shall apply whether or not the state use tax applies because ~~if~~ title to the property sold passes or is deemed to pass ~~to the purchaser~~ at a point outside this state~~, state-administered local sales tax does not apply regardless of participation in the transaction by a California retailer~~. As explained in paragraphs (b) and (c), the local use tax may apply if Regulation 1802 provides that the place of sale is not in a county having a state-administered local tax. If so, the retailer is required to collect the use tax and pay it to the board.	(a) SALES TAX (1) IN GENERAL. Except as stated in subdivision (a)(3) below, in any case in which state sales tax is applicable, state-administered Bradley-Burns uniform local sales tax is also applicable, if the place of sale as defined in Regulation 1802, is in a county imposing a state-administered local tax. In any case in which state sales tax is inapplicable, state-administered local sales tax is also inapplicable. ~~Thus, if title to the property sold passes to the purchaser at a point outside this state, state administered local sales tax does not apply regardless of participation in the transaction by a California retailer. As explained in paragraphs (b) and (c), the use tax may apply. If so, the retailer is required to collect the use tax and pay it to the board.~~ (2) DEFINITIONS. For the purposes of subdivision (a) and (b), the following definitions shall apply. (A) "Local Participation" means and includes the following activities occurring in California: (1) Taking an order for the retailer's tangible personal property at a place of business of the retailer. (2) Negotiating the sale or purchase of the retailer's tangible personal property at a place of business of the retailer. (3) Delivering, or assisting in the delivery of, the retailer's tangible personal property when the property is fulfilled from instate inventories of the retailer.

Action Item	Regulatory Language Proposed by MSLLC	Regulatory Language Proposed by San Jose
		(B) "Place of Business of the Retailer" means and includes: A permanent location owned and or operated by the retailer where sales are customarily negotiated with customers. For example, a sales office, storefront, or outlet operated by the retailer where sales are negotiated or orders are taken would be a place of business of the retailer. For the purposes of subdivisions (a) and (b), a place of business of the retailer would not include an administrative office, a location where the activities are limited to processing credit applications, or the homes or offices of agents or representatives of the retailer, including a location in which the retailer does not have a proprietary interest.
	(2) EXCEPTION. State-administered local sales tax does not apply to certain sales of tangible personal property to operators of aircraft to be used or consumed principally outside the county in which the sale is made if such property is to be used or consumed directly and exclusively in the use of the aircraft as common carriers of persons or property under the authority of the laws of the State of California, the United States, or any foreign government. On and after July 1, 1972, for county tax purposes this exemption is limited to 80 percent of the county tax.	3~~2~~ EXCEPTIONS. (A) State-administered local sales tax does not apply to certain sales of tangible personal property to operators of aircraft to be used or consumed principally outside the county in which the sale is made if such property is to be used or consumed directly and exclusively in the use of the aircraft as common carriers of persons or property under the authority of the laws of the State of California, the United States, or any foreign government. On and after July 1, 1972, for county tax purposes this exemption is limited to 80 percent of the county tax. (B) On or after July 1, 2008, when there is local participation in the sale or purchase of tangible personal property from outside this state, which is delivered to customers in California, state-administered Bradley-Burns local sales tax, not local use tax, will generally apply to the transaction whether or not the state sales tax is applicable. The exception noted in subdivision (a)(3)(B) does not apply to leases.

AGENDA — May 31, 2007 Business Taxes Committee Meeting

Proposed Amendments to Regulation 1803, Application of Tax

Action Item	Regulatory Language Proposed by MSLLC	Regulatory Language Proposed by San Jose
Proposed amendments to Regulation 1803 (b)	(b) USE TAX. State-administered local use tax applies if the purchase is made from a retailer on or after the effective date of the local taxing ordinance and the property is purchased for use in a jurisdiction having a state-administered local tax and is actually used there, provided any one of the following conditions exist: (1) ~~Title to the property purchased passes to the purchaser at a point outside this state;~~The place of sale determined in accordance with Regulation 1802 is not in this state; (2) The place of sale determined in accordance with Regulation 1802 is in this state but not in a jurisdiction having a state-administered local tax; (3) The place of sale is in a jurisdiction having a state-administered local tax and there is an exemption of the sale of the property from the sales tax but there is no exemption of the use of the property from the use tax; or (4) The property is purchased under a valid resale certificate. State-administered local use tax does not apply to the storing, keeping, retaining, processing, fabricating or manufacturing of tangible personal property for subsequent use solely outside the state or for subsequent use solely in a county not imposing a local use tax.	(b) USE TAX. State-administered local use tax applies if the purchase is made from a retailer on or after the effective date of the local taxing ordinance and the property is purchased for use in a jurisdiction having a state-administered local tax and is actually used there, provided any one of the following conditions exist: (1) ~~Title to the property purchased passes to the purchaser at a point outside this state.~~ There is no local participation, as defined in subdivision (a)(2), in the sale or purchase of the retailer's tangible personal property; (2) The place of sale under Regulation 1802 is in this state but not in a jurisdiction having a state-administered local tax; (3) The place of sale under Regulation 1802 is in a jurisdiction having a state-administered local tax and there is an exemption of the sale of the property from the sales tax but there is no exemption of the use of the property from the use tax; (4) The property is purchased under a valid resale certificate. State-administered local use tax does not apply to the storing, keeping, retaining, processing, fabricating or manufacturing of tangible personal property for subsequent use solely outside the state or for subsequent use solely in a county not imposing a local use tax.
Proposed Amendment to Regulation 1803 (d)	(d) LEASES. If a lease is a continuing sale, or a continuing purchase, for the purposes of state tax, it shall be a continuing sale, or a continuing purchase, for the purposes of local tax. If a lease is neither a continuing sale nor a continuing purchase for the purposes of state tax, it shall be neither a continuing sale nor a continuing purchase for the purposes of local tax.	(d) LEASES. If a lease is a continuing sale, or a continuing purchase, for the purposes of state tax, it shall be a continuing sale, or a continuing purchase, for the purposes of local tax. If a lease is neither a continuing sale nor a continuing purchase for the purposes of state tax, it shall be neither a continuing sale nor a continuing purchase for the purposes of local tax.

Action Item	Regulatory Language Proposed by MSLLC	Regulatory Language Proposed by San Jose
Proposed Amendment to Regulation 1802 (a)	No Impact on Leasing Transactions The clarifying amendments to Regulations 1802 and 1803 shall not create any inference with regard to how local tax revenues from leasing transactions should be reported by taxpayers and distributed to participating jurisdictions. Therefore, any inquiries filed under section 7209 with regard to leasing transactions shall be resolved as if these amendments had not been adopted. (2) RETAILERS HAVING MORE THAN ONE PLACE OF BUSINESS. **(A)** If a retailer has more than one place of business in this state but only one place of business participates in the sale, the sale occurs at that place of business. **(B)** If a retailer has more than one place of business in this state which participate in the sale, the sale occurs at the place of business where the principal negotiations are carried on. I~~f this place is the place where the order is taken, it is immaterial that the order must be forwarded elsewhere for acceptance, approval of credit, shipment, or billing. For the purposes of this regulation, an employee's activities will be attributed to the place of business out of which he or she works.~~	(2) RETAILERS HAVING MORE THAN ONE PLACE OF BUSINESS. **(A)** If a retailer has more than one place of business in this state but only one place of business participates in the sale, the sale occurs at that place of business. **(B)** If a retailer has more than one place of business in this state which participate in the sale, the sale occurs at the place of business where the principal negotiations are carried on. If this place is the place where the order is taken, it is immaterial that the order must be forwarded elsewhere for acceptance, approval of credit, shipment, or billing. For the purposes of this regulation, an employee's activities will be attributed to the place of business out of which he or she works.

AGENDA — May 31, 2007 Business Taxes Committee Meeting

Proposed Amendments to Regulation 1803, Application of Tax

Action Item	Regulatory Language Proposed by MSLLC	Regulatory Language Proposed by San Jose
	(3) Participation Normally, the place of business where participation occurs is the place where the order is taken or the sales contract is negotiated, or, in the case of out-of-state orders or negotiations, the place of business in this state where shipment occurs. Where the principal negotiations occur in state, it is immaterial that the order must be forwarded elsewhere for acceptance, approval of credit, shipment, or billing. For the purposes of this regulation, an employee's activities will be attributed to the place of business out of which he or she works. (~~3~~4) PLACE OF PASSAGE OF TITLE IMMATERIAL. ~~If title to the tangible personal property sold passes to the purchaser in California, I~~it is immaterial that title to the tangible personal property sold passes to the purchaser at a place outside of the local taxing jurisdiction in which the retailer's place of business is located, or that the property sold is never within the local taxing jurisdiction in which the retailer's place of business is located.	(3) PLACE OF PASSAGE OF TITLE IMMATERIAL. ~~If title to the tangible personal property sold passes to the purchaser in California, I~~it is immaterial that title to the tangible personal property sold passes to the purchaser at a place outside of the local taxing jurisdiction in which the retailer's place of business is located, or that the property sold is never within the local taxing jurisdiction in which the retailer's place of business is located.

Issue Paper Number **07-006**

- ☐ Board Meeting
- ☒ Business Taxes Committee
- ☐ Customer Services and Administrative Efficiency Committee
- ☐ Legislative Committee
- ☐ Property Tax Committee
- ☐ Other

BOARD OF EQUALIZATION
KEY AGENCY ISSUE

Proposed Amendments to Regulation 1803, *Application of Tax*

I. Issue

Should the Board of Equalization (Board) amend Regulation 1803 to reclassify retail transactions involving products shipped into California from outside the state, with title passing outside the state, as subject to local sales tax, not use tax, when the out-of-state retailer's place of business in California "participates" in the sale?

II. Alternative 1 - Staff Recommendation

Staff recommends that the Board make no change to Regulation 1803. The current provisions of Regulation 1803 that require the character of the local sales or use tax to be the same as the character of the state sales or use tax are supported by applicable statutes and reflect Board interpretations, policies, and procedures that have been in place for more than fifty years. Adopting a proposal that would "divorce" the local tax from the state tax would reverse well-settled law adopted and followed by prior Boards, as well as reversing long-standing interpretations, policies and procedures.

The California Retailers Association, the HdL Companies, Mr. Douglas R. Boyd, Sr., Attorney at Law (Mr. Boyd), the City of Corning, City of Lake Forest, City of Encinitas, City of Mountain View, City of San Marcos, City of Paso Robles, Orange County, and the California State Association of Counties support the recommendation to make no changes to Regulation 1803.

III. Other Alternatives Considered

Alternative 2 – As proposed by Mr. Albin C. Koch, MuniServices LLC (MSLLC), and supported by the City of San Ramon, City of San Diego, City of San Bernardino, City of Long Beach, City of Los Angeles, City of Sacramento, and Mr. Robert E. Cendejas, Attorney at Law (Mr. Cendejas), representing the City of Ontario, amend Regulation 1803 on a retroactive basis to apply local sales tax to sales of products shipped into California, with title passing outside the state, whenever there is local participation in the sales transaction. Local sales tax would apply even though the state use tax, not the state sales tax, may apply to the same transaction. For consistency, MSLLC also proposes that Regulation 1802, *Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes*, subdivision (a) be amended, on a retroactive basis.

MSLLC's proposed amendments to Regulations 1803 and 1802 are attached as Exhibits 2 and 3, respectively.

Alternative 3 – As proposed by the City of San Jose, amend Regulation 1803, operative July 1, 2008, to apply local sales tax to sales of products shipped into California, with title passing outside the state, whenever there is local participation in the sales transaction. For consistency, this alternative also proposes that Regulation 1802, subdivision (a) be amended operative July 1, 2008. The proposed amendments to Regulations 1803 and 1802 are attached as Exhibits 4 and 5, respectively.

The proposal to amend Regulation 1803 on a prospective rather than a retroactive basis is supported by the Revenue and Taxation Committee of the League of California Cities (League).

IV. Background

On October 11, 2006, the Board held a rehearing on a petition filed by the Cities of Los Angeles and San Jose (Petitioners) for reallocation of local use tax revenues reported and allocated by a specified retailer. At issue was whether the sales tax or use tax applied to the retailer's transactions. After hearing the arguments by the Petitioners and staff, the Board referred the issue to the Business Taxes Committee (BTC) process for discussion of whether it would be contrary to applicable laws to reclassify the type of transactions identified in the petition as being subject to local sales tax, even though they are subject to state use tax. Under discussion are the provisions of Regulation 1803, as well as the statutory and regulatory authority for applying local use tax to transactions involving products shipped into California from outside the state, with title passing outside the state, when the out-of-state retailer's place of business in California participates in the sale.

Staff met with interested parties on February 8, 2007, and March 22, 2007, to discuss the provisions of Regulation 1803 and the Board's authority regarding transactions in which there is local participation in the sale, but title to the property transfers outside the state.

Following the interested party meetings, staff received submissions from MSLLC, Mr. Cendejas, the California Retailers Association, California State Association of Counties (CSAC), the HdL Companies (HDL), the League, Mr. Boyd, Orange County, and a number of cities either supporting or opposing the proposed change. See Exhibit 6 for a list of the interested parties that support or oppose the proposed change.

The MSLLC April 6, 2007 submission is attached as Exhibit 7, without the attachments. Since the volume of the attachments is considerable, the entire 63-page submission is available electronically at http://www.boe.ca.gov/meetings/pdf/ip1803.pdf.

The Business Taxes Committee is scheduled to discuss the proposed changes to Regulation 1803 at its meeting on May 31, 2007.

V. Discussion

The provisions of Regulation 1803 – Regulation 1803 interprets, implements, and makes specific the application of local sales and use taxes to sales and purchases of tangible personal property (property) established by Revenue and Taxation Code (RTC) sections 7202 and 7203 of the Local Tax Law. As authorized by RTC sections 7202 and 7203, California cities and counties are allowed to impose a local sales tax and a local use tax by adopting a local ordinance under the terms of the Local Tax Law. All cities and counties in this state have adopted such an ordinance. In adopting ordinances under the terms of the Local Tax Law, the cities and counties, in effect, give up the ability to: (1) impose a rate of tax separate from that imposed under the Local Tax Law; (2) define their own tax base; (3) characterize the tax; and (4) administer the tax separately.

Under RTC section 7202(b), the sales tax portion of any county ordinance adopted must, with limited exceptions, contain provisions identical to those contained in Part 1 (commencing with RTC section 6001) insofar as they relate to sales taxes. RTC section 7203(a) requires that the use tax portion of any county ordinance adopted contain provisions identical to those contained in Part 1 (commencing with RTC section 6001) insofar as they relate to use taxes. That is, the Local Tax Law follows the State Sales and Use Tax Law (State Tax Law). In furtherance of this scheme, the Board's Regulation 1803(a)(1)

requires that the local sales tax may apply *only* if the state sales tax is applicable. Thus, the local sales tax applies when the state sales tax applies and the local use tax applies when the state use tax applies. When the state sales tax is *not* applicable, the local sales tax is also *not* applicable.

The linkage between the state and local use tax schemes has been present since the inception of the Local Tax Law. Staff notes that Ruling 2203, the predecessor to Regulation 1803, contained the following provision when it was adopted by the Board on **May 1, 1956**:

> "In any case in which state sales tax is inapplicable under Ruling 55 [predecessor to Regulation 1620], state-administered local sales tax is inapplicable. Thus, if title to the property passes to the purchaser at a point outside this State, state-administered local sales tax does not apply regardless of participation in the transaction by a California retailer."

The reference to Ruling 55, which, like its successor Regulation 1620, describes the situations under which the state sales or use tax applies when transactions involve activities taking place in more than one state, was removed when Ruling 2203 was renumbered as Regulation 1803. However, the above provisions were retained in the current provisions of Regulation 1803. As was the case when Ruling 2203 was adopted in 1956, with limited exceptions not relevant to this discussion, Regulation 1803 has always provided that the local sales tax does not apply to transactions in which state sales tax does not also apply, and specifically, that the local sales tax does not apply to transactions where title to tangible personal property passes outside this state.

In its April 6, 2007 submission (see Exhibit 7, pages 1-2), MSLLC continues to disagree with the statutory authority for the provisions of Regulation 1803. MSLLC states that:

> "[T]he initial Board [r]egulations implementing the Bradley-Burns statute in 1956 conclusively sourced local revenues from 'exercise of the privilege of selling personal property' to the 'place of business' where the exercise occurred, without regard to where title or ownership passed. These [r]egulations were altered **retroactively** by the Board in 1970 and 1971 without statutory authority in an unlawful attempt to cause the sales at issue to be subject to the Bradley-Burns use tax rather than the sales tax. These drastic changes caused revenues to be distributed through county pools, rather than directly to the jurisdiction where the place of business that originated the sales was located. Thus, local revenues that had been distributed to many jurisdictions directly were shifted to formula distribution through county pools overnight….
>
> "…the commercial law test of where ownership passes has always applied in determining whether the state sales tax applies. But the 'in this state' test does not appear in RTC sections 7202 and 7205, the Bradley-Burns sales tax statute, either directly or by cross-reference, and therefore the commercial law test is irrelevant to how the local sales tax applies. Nevertheless, Board [s]taff has administered the local tax as if it did since at least 1986, and probably as early as 1971. (In 1986, this problem was first brought to the attention of the Board by a reallocation request which is still outstanding and undecided.)"

Staff agrees that the Board has administered the Local Tax Law to require, in part, that the sale of property occur in this state for local sales tax to apply to the sale. Staff presented documentation in the Second Discussion Paper (available at http://www.boe.ca.gov/meetings/pdf/SDP1803_text.pdf) and at the second interested party meeting to confirm that this is and has been the Board's position since the inception of the Local Tax Law. There is no evidence in the Board's historical documents that the Board's adoption in 1956 of regulatory language to clarify that title had to pass in California for local

sales tax to apply and the later renumbering of Regulation 1803 resulted in a regulation that is invalid. Board staff has not found, and no interested party has presented, specific corroboration of MSLLC's contention that there has been any change in administration or policy that has resulted in a shift from direct distribution of local tax revenues based on the place of sale to formula distribution to the jurisdictions of use through countywide pools for these transactions.

The interpretation of the type of transactions under discussion as being subject to use tax, not sales tax, is based on the nature of the underlying tax. It is thus not the Board's method of applying the use tax ordinance of the purchaser's jurisdiction, either through direct distribution or through the pooling process, which causes these transactions to be subject to use tax rather than sales tax; it is the construction of the State Tax Law as found in Regulation 1620. As MSLLC acknowledges in its submission, Board regulations are to be harmonized to the extent possible. The provisions in one regulation should not contradict the provisions of another.

Regarding the allocation of the tax revenues, staff does not agree with MSLLC's opinion that a sudden change in treatment occurred in the 1970's. Staff's research into this matter resulted in the confirmation that transactions such as those under discussion have historically been treated as local use tax transactions subject to distribution to the county of use, through the pooling process when applicable, not directly to the city or county where the instate place of business of the retailer selling the property is located. These transactions have been treated in the same manner since long before the renumbering of the regulations in 1970 and 1971.

Regulation 1620; an interpretation of Ruling 55 (a predecessor to Regulation 1620) – In its April 6, 2007 submission (see Exhibit 7, pages 6-7), MSLLC makes the following statements in response to staff's discussion of *Sales Tax General Bulletin 52-5* (an interpretation of Ruling 55) in the Second Discussion Paper. The statements pertain to the perceived importance of its inclusion in the provisions of renumbered Regulation 1620 in 1970, and the fact that similar language was included in Ruling 2203, predecessor to Regulation 1803, when it was adopted by the Board in 1956:

> "The express language of the Bulletin reflects that the purpose of the ruling was to apply the geographic title passage test to define the 'in this state' requirement of the state sales tax contained in RTC section 6051. Neither Ruling 55 nor [Ruling] 2015 [a predecessor to Regulation 1620 and a successor to Ruling 55] was revised in light of the ruling, so it is incorrect to interpret it as applicable to the Bradley-Burns sales tax or for any purpose other than locating the place of sale for state sales tax purposes. By its own terms, the ruling has no relevance to how the Bradley-Burns sales tax applies, because there is no statutory requirement that the incidence of the state sales tax also govern for Bradley-Burns sales tax purposes….
>
> "It is also very clear that a 1952 staff interpretation of Ruling 55 cannot alter the intent and meaning of the independent Bradley-Burns sales tax statute enacted three years later. Nor can it alter the 'conclusive presumption' provided in RTC section 7205, as reflected in the initial and later versions of Regulation 2202 [predecessor to Regulation 1802] that participation in a sales tax transaction sources the local tax to the place of business where the participation occurs. That rule remained in effect until [Ruling] 2202 was amended in 1970 and renumbered as [Regulation] 1802 to include present subdivision (a)(3), which added an in-state title passage rule for the first time as a condition for applying the Bradley-Burns sales tax. There was no statutory authority to make that change, and therefore, it has always been invalid.

> "The 1956 cross-reference to Ruling 55… in [Ruling 2203] contains no reference to Sales Tax [General] Bulletin 52-5 or to the 'title' passage rule that Board [s]taff now claims to have been automatically incorporated under staff policy in [Regulation 1620]…. If that had actually been the case, there would have been no reason to add the extensive references to title passage that appear in state sales tax [R]egulations 1620 and 1628 (b)(3)(D) and in Bradley-Burns Regulation 1802 (a)(3) in 1970 and 1971.
>
> "The primary function of Ruling 55 and [Ruling] 2015 was how the federal constitution's negative ('dormant') commerce clause had been interpreted to apply to state and local sales taxes. These rules apply across-the-board to both state and local tax measures. Without another purpose in mind, there would have been no reason to add the cross reference to these authorities in Regulation 1803, because federal constitutional considerations will always be applicable to local sales tax. Therefore, the presence of language denying an explicit title passage rule in [Ruling] 2015 was probably the reason for the cross reference…."

Staff does not agree with the conclusions reached by MSLLC. Although MSLLC is correct in its statement that the interpretation relates to state sales taxes, staff believes it also holds importance for local sales tax purposes. Staff also believes that the Board's inclusion of a restatement of the interpretation in Regulation 1620 (as supported by the 1970 Board meeting minutes) and the inclusion of the title transfer reference in Regulation 1802 when it was renumbered are valid.

In the Board's explanatory guidance dated April 21, 1952 (*Sales Tax General Bulletin 52-5*), the subject of whether sales tax applied to the type of transactions currently under discussion was clarified and an interpretation of Ruling 55, *Interstate and Foreign Commerce*, issued. As clarified in the correspondence, "if title to the property passes to the purchaser at a point outside California, the sale, as defined in Section 6006 of the Sales and Use Tax Law, does not occur in this State." Accordingly, where the title transferred, even when there was instate participation in the sale, was as relevant in 1952 as it is now.

Regulation 1620(a)(1), **Sales Tax**, as amended and renumbered December 9, 1970, in part to incorporate the interpretation of Ruling 55 contained in *Sales Tax General Bulletin 52-5*, included the following provision relevant to the transactions under discussion:

> "If title to the property sold passes to the purchaser at a point outside this state, or if for any other reason the sale occurs outside this state, the sales tax does not apply, regardless of the extent of the retailer's participation in California in relation to the transaction."

Since Ruling 2203 cross-referenced Ruling 55 when determining the character of the local tax, staff maintains that it is significant that it contained the following provision when it was adopted by the Board on May 1, 1956, four years after *Sales Tax General Bulletin 52-5* interpreted Ruling 55:

> "In any case in which state sales tax is inapplicable under Ruling 55, state-administered local sales tax is inapplicable. Thus, if title to the property passes to the purchaser at a point outside this State, state-administered local sales tax does not apply regardless of participation in the transaction by a California retailer."

Thus, it is essential to understand the interpretation of Ruling 55 discussed in *Sales Tax General Bulletin 52-5* in order to understand how the Local Tax Law applied to these types of transactions at its inception. There is no ambiguity between the provisions of Ruling 55 or Ruling 2015 (both predecessors to Regulation 1620) and Regulation 1803 between 1956 and 1970. Under both regulations, the state sales

tax and the local sales tax *did not* apply where title to property passed outside this state. This appears to be very indicative of the prior Board's interpretation of both the State and Local Tax Laws. For further discussion regarding MSLLC's and staff's views on the history and relevance of the various rulings and renumbered regulations, please refer to the Second Discussion Paper available at http://www.boe.ca.gov/meetings/pdf/SDP1803_text.pdf.

Transportation Charges – In its April 6, 2007 submission, MSLLC also reiterates its belief that the provisions of Regulation 1628, *Transportation Charges*, subdivisions (b)(3) and (b)(4), support MSLLC's view that the types of transactions under discussion were previously treated as sales tax transactions. As additional support for this belief, MSLLC cites the California Supreme Court's 1959 ruling in Select Base Materials v. State Board of Equalization (1959) 51 C. 2d 640, 645. As stated by MSLLC:

> "The case law regarding where a sale occurs for state tax purposes and [Ruling] 2028 (renumbered Regulation 1628 in 1971) support MSLLC's interpretation that the type of transactions at issue in this proceeding were normally treated as subject to sales tax by the Board's regulation during the 16-year period from 1956 thorough 1971, unless the taxpayer could provide, first detailed proof, and later 'clear and convincing' evidence to the contrary…."

Staff believes MSLLC's conclusion that the provisions of Regulation 1628 provide support that Regulation 1803 is invalid is misplaced. Regulation 1628 makes specific the application of tax to charges for transportation by facilities of the retailer and charges for transportation by a carrier, with title transferring at the destination. The provisions of Regulation 1628 are to be used to determine how tax on delivery charges should be calculated once the character of the tax is determined, not to determine *whether* sales tax rather than use tax applies. The provisions of Regulation 1628 should not be construed to invalidate or contradict the title transfer provisions of Regulation 1803. Similarly, *Select Base Materials* held that whether transportation charges were subject to sales tax depended on whether the transportation occurred before or after title transferred, and made no issue of the retailer's burden of proof.

Is the Local Tax Law required to follow the State Tax Law? Regarding this issue, MSLLC provides, in part, the following comments in its April 6, 2007 submission (see Exhibit 7):

> "Present Regulation 1803 is incorrect in requiring the Bradley-Burns use tax to apply if the [s]tate use tax applies. The County and City ordinances are independent of the [s]tate sales and use tax statute, and the Bradley-Burns statute specifically excludes the [s]tate use tax statute. (See RTC [subdivision] 7203 (e).) The county and the city use tax provisions also contain exemptions from the use tax if the local sales tax applies. See RTC [subdivisions] 7202(h)(5) and 7203(c). Therefore, the Bradley-Burns sales tax must be applied first to determine whether it applies. If it does, the local use tax cannot apply….
>
> "In interpreting whether the Bradley-Burns sales tax applies, the local ordinances and the Bradley-Burns statute govern. There is no language that requires the state sales tax to govern whether the Bradley-Burns sales tax applies, and there is both statutory and regulatory language that exempts Bradley-Burns from the "place of sale" rules for [s]tate sales tax (See RTC [s]ection 6010.5 and Regulation 1628 (b)(4))….
>
> "The ordering rule implicit in both the state and the local sales and use taxes is that applicability of the sales tax is always to be considered before the applicability of the use tax. RTC [s]ection 6401, and subdivisions (h)(5) of RTC [s]ection 7202 and (c) of 7203 all state that

> transactions are exempt from the use tax under both statues if the sales tax applies. This is to be expected, because the use tax is supposed to "back up" and be complementary to the sales tax. Another way of saying this is that if the sales tax applies, there is no need for a use tax and it does not and cannot apply. The firm rule is not reflected anywhere in present Regulation 1803.
>
> "Nor is there any statutory support for the rule stated in Regulation 1803 that the Bradley-Burns use tax must apply if the state use tax does. In fact, RTC section 7203 has always expressly excluded the basic state use tax statute, RTC [s]ection 6201, from being incorporated by reference in Bradley-Burns. Thus it is clear that the Bradley-Burns use tax applies only on its own terms and was never intended by the Legislature to be governed by state rules."

Staff agrees that determining whether local sales tax applies to a transaction should be governed by the applicable Local Tax Law, which contains provisions identical to the applicable State Tax Law, as required by RTC sections 7202(b) and 7203(a). Staff also agrees that local sales tax and local use tax cannot be applied to the same transaction. The sales tax and the use tax are mutually exclusive. Once a transaction is defined as being subject to use tax under Regulation 1620, the only local tax that can apply is the local use tax. Staff believes that contractually and under the law, once it is determined that the local sales tax does not apply, the Board is required to apply the use tax ordinance of the participating jurisdiction in which the purchaser, the person liable for the tax, resides.

Regarding RTC section 7203(a), the requirement that the provisions of the section not include provisions identical to RTC section 6201 is an understandable requirement. Since both RTC sections 6201 and 7203 provide the authority for the imposition of an excise (use) tax, there is no reason to incorporate provisions identical to those provided by RTC section 6201 in the Local Tax Law. However, this should not be perceived as evidence that the local tax does not follow the state tax.

In addition, the fact that RTC section 7203(e) may only provide a partial exemption from the local use tax when the state and district laws provide for a full exemption does not mean there is not a requirement that the local tax follow the state tax. Similarly, the fact that RTC section 7202(h) provides a credit for the taxes due under a city ordinance when the same transaction is subject to the taxes due under a county ordinance does not invalidate the provisions of Regulation 1803 that local sales tax is only applicable when state sales tax is applicable.

In its May 4, 2007 submission, CSAC states its agreement with staff's long-standing interpretation of RTC sections 7202 and 7203 and provides the following comments (see Exhibit 6, pages 4-5).

> "…Sections 7202 (b), relating to the local sales tax, and 7203 (a), relating to the local use tax, require in part that local agencies that opt into the 'Bradley-Burns Uniform Local Sales and Use Tax' include in their implementing ordinance 'provisions identical to those' that govern the state's sales and use tax laws. They also require a provision that 'all amendments [to the state codes]…shall automatically become a part of the sales tax ordinance of the county.' These code sections make it exceedingly clear that local agencies that have chosen to participate in the Bradley-Burns system – all cities and counties have made that choice – agree that *the characterization of their local sales and use taxes will exactly mirror those of the state* [emphasis in original].
>
> "The proposal under consideration would subvert that requirement by having some transactions characterized as a state use tax but a local sales tax. This would not only be confusing for persons doing business in this state, but would directly contradict California law. The Board of

> Equalization's tax regulations exist to carry out and clarify statutes, and cannot contradict or undermine them. This proposed change brings before the Board primarily a legal question, so the Board must primarily look to the law for the answer. Therefore, on this basis alone, the Board must reject the proposed change."

The "conclusive presumption" regarding place of sale – MSLLC also states in its submission:

> "…that Regulation 2203, as first adopted in 1956, was administered to recognize the 'conclusive presumption' adopted in Regulation 2202 that Bradley-Burns revenues were to be sourced to the retailer's California 'place of business' where sales were negotiated or orders taken."

In short, MSLLC contends that RTC section 7205 and the Board's Regulation 1802 have always required the local sales tax to apply whenever an instate place of business of the retailer negotiates a sale or takes an order. Staff agrees that the provisions of RTC section 7205, interpreted and implemented by Regulation 1802, contain a *conclusive presumption* that local sales tax revenues are to be sourced (allocated) to the jurisdiction where the California place of business of the retailer is located, which is determined under Regulation 1802 once it is also determined that local sales tax is the applicable tax. However, staff does not agree with MSLLC's opinion that RTC section 7205 determines whether the local sales tax is the applicable tax. By its terms, RTC section 7205 governs the allocation of local sales tax (by determining the "place of sale") *only* when the local sales tax applies. The local use tax is allocated pursuant to well-settled rules based on where the property at issue is first functionally used. Local use tax is allocated to the registered place of business of use when the property is used at that location. Otherwise, it is allocated via the county pool process, which has been in place since the inception of the Local Tax Law in 1956. The place of sale is not relevant if the local use tax applies.

Furthermore, the conclusive presumption was not intended to override the fundamental condition that the sale must occur in this state in order for the state and local sales taxes to apply. The conclusive presumption was enacted to deal with the inter-jurisdictional conflict present under many pre-Bradley-Burns local ordinances because sales that involved delivery to other jurisdictions were exempt from the local sales tax. Staff has not identified any evidence that the conclusive presumption was intended to cause the local sales tax to apply if title passed outside this state. Rather, the minutes of the 1956 Board meetings at which Ruling 2203 was adopted and amended demonstrate that the parties involved in drafting the Bradley-Burns legislation and contemporaneously adopted Board regulations agreed that the local sales tax would *not* apply when title passed out of state. No interested party has provided any credible evidence or argument otherwise.

Relationship of Regulation 1803 and Regulation 1802 – As previously stated, Regulation 1803 interprets, implements, and makes specific the provisions of RTC sections 7202 and 7203 as they relate to the determination of whether local sales or use tax applies to a transaction. The primary purpose of Regulation 1803 is to provide guidance regarding whether local sales or use tax applies to specific transactions, not to determine the city or county where the local sales tax should be allocated once it is determined to apply; Regulation 1802 provides that guidance. Neither Regulation 1802 nor Regulation 1803 takes precedence over the other or has more significance than the other. They both provide necessary guidance based on their interpretations of the applicable provisions of the Local Tax Law apart and separable from the other, i.e., each regulation "stands on its own." Regulation 1803 clarifies when the local sales tax applies to a transaction and Regulation 1802 provides the rules for the allocation of the local sales tax once it is determined to apply.

Staff believes it is reasonable to conclude that if Regulation 1803 were intended to interpret the place of sale rules of RTC section 7205 as statutory authority for determining *whether* local sales tax applied to a transaction, then one could reasonably conclude that those provisions would have been included in the regulatory language of Regulation 1803 when it was adopted in 1956 and in any amendments that followed. Although the provisions of RTC section 7205 are referenced by the regulation for determining whether local use tax may apply in certain circumstances, this has never been the case for local sales tax purposes. Regulation 1803 does not look to RTC section 7205 or Regulation 1802 for authority in determining whether local sales or use tax applies to a transaction.

Staff does recognize that the language of a regulation(s) that interprets the applicable State Tax Law may be restated, incorporated, or referenced when implementing or revising a regulation that interprets the Local Tax Law. Since the Local Tax Law follows the State Tax Law, it is common for regulations interpreting the State Tax Law to be used as a reference for the provisions of regulation. One regulation may also reference another regulation. However, this fact should not be inferred to provide authority or a basis for the provisions of one to govern or invalidate the provisions of another.

An analysis of the case law referred to by MSLLC – MSLLC references the *Diebold* case (see Exhibit 7, pages 8-9) as support for its contention that local sales tax, not local use tax, applies to the type of transactions under discussion. However, staff believes that *Diebold* requires the use tax to apply to all transactions, including those under discussion here, where title transfers outside this state. MSLLC states:

> "The leading California precedent on place of sale is Diebold, supra, which is cited as authoritative in the Board's Business Taxes Guide, b. 1, p.1078 (2004-1) under RTC [s]ection 6051. Board Legal [s]taff has claimed to rely on that case for years in interpreting when and where the Bradley-Burns sales tax applies. It applies a facts and circumstances approach based on the underlying commercial law governing where a sale is completed.
>
> "The facts in Diebold were similar to those in Cities of Los Angeles and San Jose in that the Taxpayer had permanent places of business in California that originated sales to California purchasers that were fulfilled by shipment directly to the purchasers. Although the case was decided after Bradley-Burns was adopted, the periods involved appear to have preceded April 1, 1956[,] when it went into effect. The opinion never mentions city sales taxes and analyzes the transactions at issue based upon the terms of the governing contracts or invoices and related facts. One set, the so-called 'bank agreements,' was determined to constitute 'delivery' contracts under the USA, Civ. Code Section 1739 (5), only because they provided, inter alia, that the retailer was to pay the shipping costs. Another set of three contracts was determined to transfer ownership of the property outside California, because they indicated that 'title' was to pass upon shipment from Ohio and the USA, Civ. Code Section 1739 equated that term with the 'property' meaning full ownership. It was held that the sales tax could not be applied to these sales, presumably because they did not occur 'in this state' under RTC [s]ection 6051, and the use tax was not at issue.
>
> "The third set of agreements provided that the Taxpayer retained 'title' as security until payment in full had been received, and the facts indicated that installments remained to be paid after delivery had occurred in California. These transactions were held to be subject to sales tax because the Court determined that possession had transferred in California, not upon shipment in

> Ohio. RTC [s]ection 6006 (e) still states that such transfers of 'possession' constitute taxable 'sales' for sales tax purposes, but Board [s]taff refuses to recognize this statutory rule.[1]
>
> "Thus, Diebold, the leading opinion for applying the state sales tax to shipments from out of state, conducted a detailed analysis of the contracts and the underlying commercial law to determine where 'property' or ownership of the property transferred. Certain contracts were construed to constitute 'delivery' contracts, even though they didn't say so in so many words or contain any 'FOB' terminology, because the taxpayer was unable to satisfy its burden of proof that the sales tax did not apply.
>
> "Therefore[,] the basic methodology used in Diebold is still good law. The only change mandated by the CUCC is that now the analysis must be performed under the revolutionary revisions of sales law contained in Division 2 to determine when the sale process has progressed to a point where it may be concluded legally that the purchaser has become the owner of the property and the seller is entitled to receive or retain payment. Under both the CUCC and, as exemplified in Diebold the prior USA, this analysis is to be performed on a step-by-step basis, at least for California state sales tax purposes. There is no California case law that holds the Legal [s]taff's 'bright-line test' under CUCC Section 2401 (2) governs characterization of the state sales tax."

Staff disagrees with MSLLC regarding the propositions for which the *Diebold* case stands in relation to the issue under consideration. To the extent the case relates to whether the Board imposed state and local use taxes to transactions in which title passed outside the state during the years prior to 1971 (as previously stated in the Second Discussion Paper issued on March 13, 2007), the *Diebold* court affirmed that the Board correctly did not apply the state sales tax when it was found that title passed out of state. In *Diebold*, at p. 631, the court examined transactions in which customers placed orders through a California office of an out-of-state retailer. The goods were delivered directly to the customers in California from the retailer's manufacturing location in Ohio. (*Ibid.*) The Court found that the participation by the local office of the retailer was sufficient to support the sales tax on Constitutional grounds if a state so chose, as explained in *Norton Co. v. Dept. of Revenue of the State of Ill.* (1951) 340 U.S. 534. (*Diebold, supra*, at 633.)

However, in order to impose the sales tax under California law, more was required. For three transactions where title transferred to the California buyer upon delivery to the common carrier in Ohio, the court held that, since title passed outside of California, sales tax was not applicable, even though the local office of the retailer participated in the sales. (*Id.* at 639.) Conversely, where title passed in California, the sales tax applied where there was local participation. Thus, *Diebold* mandates the results reached by application of Regulations 1620 and 1803, which require the state and local use tax, respectively, to apply where title transfers outside this state, even if there is in-state participation by the place of business of the retailer. Staff notes that MSLLC provides no support for its assertion that retailers from 1956 through 1971 paid the state sales tax because of the "inconvenience" of meeting the burden of proving otherwise, but believes that the issue of burden of proof (mentioned by MSLLC in connection with its discussion of

[1] "A similar transfer-of-possession rule applies under the definition of taxable 'sale' contained in RTC [s]ection 6006 (f) for transfers of 'title or possession of tangible personal property which has been produced, fabricated, or printed to the special order of the customer, or of any publication.' Both provisions defining transfers of 'possession or title' as 'sales' under RTC [s]ection 6006 (e) and (f) are inconsistent with the [s]taff's current 'bright-line test' under CUCC Section 2401 (1)-(4), because that test fails to recognize transfers of possession as taxable 'sales' and is not based on when and where ownership passes for general commercial law purposes. Allocation appeals involving both RTC subdivision 6006 (e) and (f) are pending."

the *Diebold* and *Select Base Materials v. State Bd. of Equalization* cases) is irrelevant as Regulations 1802 and 1803 assume that the issue of where title passed has already been resolved.

MSLLC also cites a number of cases from other jurisdictions (and one federal Bankruptcy Court case interpreting California law) that purport to demonstrate that other states do not impose the same local taxation schemes as California (see Exhibit 7, page 13). Staff has reviewed the cases and determined that they do not add significantly to the discussion, as they primarily demonstrate the approach of various states in determining where and when title transfers for commercial and tax law purposes. Since the Board's regulations interpret California statutes, restricted only by relevant federal authorities (e.g., United States Supreme Court), and Regulations 1802 and 1803 assume that any issues regarding transfer of title are resolved before the character of the tax, the place of sale, and the allocation or distribution methods are determined, staff has omitted discussion of these cases.

Report issued by Legislative Analyst's Office (LAO): In its January 2007 report, the LAO identified the inequities and unproductive competition that can result from cities and counties competing with another for the local sales tax revenues generated by a business. The LAO report (available at http://www.lao.ca.gov/2007/sales_tax/sales_tax_012407.pdf) discussed problems associated with local agencies offering incentives to retailers to relocate to their jurisdiction. For example:

> "One manifestation of unproductive competition is the use of sales tax rebates and other financial incentives by local agencies to sales tax-generating businesses locating within their borders. These have been used to encourage the relocation of sales offices and the creation of 'buying companies' for the purposes of diverting sales taxes. The use of financial incentives does not result in net benefits to a broader economic region within the state. It simply shifts existing sales taxes from one jurisdiction to another, the cost of government resources that could be used for other purposes….
>
> "Over the years, when large retail establishments have considered relocation or expansion into a region, local governments have often competed against one another by offering the business ever more generous packages of incentives to operate within their borders. From a state standpoint, this competition among jurisdictions for sales tax revenues generally is unproductive. There is a finite market for retail spending within an economic region. Thus, the main result of the various incentives offered to the business is simply a relocation of the retail activity from one community to another—with no net gain in economic output or efficiency to the region or state as a whole. In addition, the cost of the economic incentives drain local government resources that otherwise would be available for public purposes."

In response to staff's statement in the Second Discussion Paper that MSLLC's proposed changes will result in a significant potential for the type of counterproductive activities identified in the LAO report, MSLLC provides the following comments (see Exhibit 7, page 12):

> "The LAO [r]eport does not mention the type of transaction involved in this Interested Party Proceeding as being particularly vulnerable to the rebate contracts described in it. In fact, to MSLLC's knowledge, none of the pending Mass Appeal or other claims of the type involved here, including those arising in Cities of Los Angeles and San Jose, have rebate agreements in place.
>
> "The expansion of the annual volume of transactions subject to the sales tax as opposed to the use tax is expected to be minimal, in any event. The amounts at issue in Cities of Los Angeles and San Jose are relatively modest."

Staff believes the LAO report discusses the concerns of that office and what is occurring in today's environment and may well occur in the future. Staff also believes that if the Board were to adopt the MSLLC proposed change, retroactively or prospectively, the potential for the type of incentives and rebate agreements discussed in the LAO report would be genuinely and significantly increased. The fact that the amounts at issue in the Petitioner's case may not be related to rebates and incentives has no bearing on what other cities and counties may do in the future.

Staff believes that it is likely that jurisdictions will offer extensive rebates to out-of-state retailers that are already required to collect state use tax to set up an office in their jurisdictions to conduct the minimum amount of participation necessary to sustain the local sales tax on each sale. Then, even though the state use tax applies and the property may be purchased for use at any location in California, all local tax revenues for that seller will go to the jurisdiction offering the rebate. Every other city and county in California will lose local tax revenues. This creates enormous incentives for local jurisdictions to offer rebates to these sellers, to the detriment of every other jurisdiction in the state. Staff believes that amending these regulations will compound the issues discussed in the LAO report.

In its May 4, 2007 submission, CSAC also expresses concern regarding the potential for rebates and incentives between retailers and jurisdictions if the proposal to amend Regulation 1803 were adopted.

> "If the proponent's proposal were to become law, it would further invite a certain type of abuse whose use has accelerated rapidly over the past few years. Under these arrangements, a local jurisdiction agrees to refund to a retailer a certain percentage of the sales tax they generate – as high as 85% in some of the most recent cases – for artificially consolidating their state or region-wide sales in one location within the city's limits. This belies the fact that the sales are in fact coming from many different jurisdictions. A small office of two or three individuals could funnel statewide sales to an out-of-state company in order to reap great financial rewards to the detriment of citizens in all of the jurisdictions where these products are actually being used. This is public money that is going directly to private hands with no resulting benefit to the general public. Sales and use taxes are critical to providing public services and facilities such as public safety and roadway maintenance to residents of this state. Misusing them in this way not only diminishes these services and facilities, it increases the share of the tax burden borne by natural persons and less wealthy and influential companies, since the large companies that generate the most sales tax are the most lucrative and therefore most likely with which to make these sorts of arrangements."

When may local tax revenues be reallocated? As authorized by RTC section 7209, the Board **may** redistribute tax, penalty, and interest distributed to a county or city other than the county or city entitled to the revenues, but such redistribution shall not be made as to amounts originally distributed earlier than two quarterly periods prior to the quarterly period in which the Board obtains knowledge of the improper distribution. A date of knowledge of improper distribution can generally be established when (1) an inquiry is received from an inquiring local jurisdiction or its Consultant (IJC) for investigation of suspected improper distribution of local tax or (2) staff discovers factual information sufficient to support the probability that an erroneous allocation of local tax may have occurred, and the allocation is questioned. A date of knowledge (hereafter, DOK) is established when a Board employee questions the allocation.

Under the MSLLC proposal, a retroactive application of the proposed change would result in the reallocation of local tax revenues from as far back as 1995 (there are also numerous inquiries with a DOK earlier than 1995). Although there would be no reduction in the total local tax revenues, adoption of the current proposal would result in shifts in local revenues among cities and counties, as well as shifts from

county to county, resulting in major "winners" and "losers." The losing jurisdictions would have spent the revenues received in the past and would not have taken into consideration such reallocation of funds in their current or future budgets. Reallocating funds distributed during the last twelve years appears contrary to the intent of the sponsors of RTC section 7209, which staff believes was designed to prevent such a major impact on losing cities and counties. In many instances, it will likely cause a severe financial hardship on the losing cities and counties. (See Exhibit 9 for an illustration of the revenue losses a jurisdiction could incur under a reallocation of county pool revenues.)

Regarding the impact of reallocating local tax revenues previously distributed to cities and counties, CSAC provides the following comments in its May 4, 2007 submission (see Exhibit 6, pages 4-5):

> "Due to over two decades' worth of claims, the amount of money involved in a retroactive implementation of this proposal is staggering. It is important to keep in mind that this is not only public money against which many jurisdictions have bonded, but in the case of retroactive application this is money that jurisdictions have already spent: spent on roads, peace officers, parks, water supply, health services and hospitals, et cetera. So the Board [if they were to adopt MSLLC's proposal] would be creating liabilities for nearly every local agency in the state, since according to the Board's analysis this change would negatively impact almost every jurisdiction, while having a positive effect on only a few. So the public-at-large would suffer due to an obscure regulatory change that is supported neither by statute nor by history."

Staff notes that cases under appeal receive the greatest benefit from retroactivity since the DOK would go back to the date the inquiry was received. However, for cities and counties who did not file inquiries because they understood that the transactions fell outside of the clear provisions of the regulation; or perhaps who submitted an inquiry, but did not appeal the Board staff's denial, redistribution would be limited to the current quarter and the two preceding quarters, and only for those retailers who have the type of transactions that would be affected by these amendments. Under Alternative 3, the proposed amendments would be limited to those transactions occurring on or after July 1, 2008. In other words, reallocation limitations are such that cases currently in the appeals process receive a greater benefit from a retroactive regulation change than those that followed the current provisions of the regulation.

Regarding this subject, MSLLC states the following in its April 6, 2007 submission (Exhibit 7, page 5):

> "Staff should assess the potential impacts of the proposed changes in conjunction with qualified representatives of local government. Management of the necessary corrections of all past misallocations that are still pending and the transition to applying the Bradley-Burns statute and ordinances to this type of transaction should be conducted separately from this regulatory proceeding and in a fair, efficient and equitable manner that reflects the Board's obligations under the Bradley-Burns contract and RTC [s]ections 7209 and 7204. The only corrections necessary to consider concurrently with this proceeding are limited to those that would be required to dispose of the ruling in Cities of Los Angeles and San Jose that was taken under submission pending this regulatory proceeding."

Further, MSLLC provides the following comments relating to the subject of RTC section 7209 and what MSLLC considers a "major procedural" issue:

> "A major procedural issue concerns whether the Board [s]taff's Discussion Papers are correct in implying that clarifying the current regulations retroactively as requested would also necessarily require full retroactive correction of all the other outstanding claims involving whether Bradley-Burns sales tax applies to the transactions now at issue before the Board Members in Cities of Los

> Angeles and San Jose…. None of the other similar cases have yet been presented to the Board Members, and therefore, consideration of their disposition under Section 7209 of the Revenue and Taxation Code in this Interested Party proceeding would appear to be both premature and unnecessary. Neither Discussion Paper addressed this concern."

Staff does not agree that it is premature to consider the totality of the impact on jurisdictions if the proposed changes to Regulation 1803 were adopted by Board[2]. If the Board does not specifically limit the retroactive effect of a regulatory action, it is retroactive to the applicable statute of limitations, usually three years, and includes any open inquiries. In this case, there are a significant number of inquiries currently under appeal by MSLLC, including those of the Petitioners, which are based on the same or similar arguments presented by MSLLC in the petition of the Cities of Los Angeles and San Jose. Staff believes it is appropriate to illustrate the amount of local tax revenues, even on an estimated basis, that would be expected to be reallocated from the county pools to the specific jurisdiction of where the local participation occurred.

If the changes proposed by MSLLC were adopted on a retroactive basis, a redistribution of the local tax would be made up to two quarterly periods prior to the quarterly period in which the Board obtained knowledge of improper distribution. In the case of the "mass appeal," the Board obtained knowledge over twelve years ago for many of the appealed cases and almost 20 years ago for others. Accordingly, if the proposal were adopted and given a retroactive effect, the amount of local revenues that would be redistributed is very significant.

In its April 5, 2007 submission (see Exhibit 6, page 6), HDL expresses its concern over the burden on local government if the MSLLC proposal were adopted:

> "No one knows the true dollar impact of allowing the proposed changes to apply retroactively …. However, it is agreed that it would result in the largest tax shift in the history of the Bradley Burns Local Sales & Use Tax program and that the vast majority of the cities and counties in the [s]tate would have to pay back monies that have long been spent. Not even agencies with pending claims can be assured that they would be net 'winners' after all redistributions were completed. It is this very type of situation that R&T section 7209 was designed to prevent."

In his April 6, 2007 submission, Mr. Boyd also expresses opposition to the MSLLC proposal to amend Regulation 1803. Mr. Boyd states that:

> "Changing the rules after the game is played is inherently unfair, fraught with unintended consequences and [is] guaranteed to produce inaccurate results. In these matters, it would be a major burden on government entities and taxpayers to reconstruct records going back to the early 1990's. That is one reason why the California Retailers Association and California State Association of Counties oppose retroactivity. Board staff also strongly opposes retroactivity, and for good practical reasons. It would be their job to work with thousands of taxpayers and local jurisdictions to reconstruct records of transactions long forgotten. Many records from ten to fifteen years ago no longer exist…."

The 1996 Impact Study – In 1996, an internal study was done by staff in response to a request by the BTC to identify the cities and counties that would be "winners" and "losers" if certain amendments to

[2]Staff notes that it is premature for Board staff to start working the open inquiries prior to a decision by the Board on the validity of Regulation 1803, as suggested by MSLLC. Board management previously denied these claims under the current provisions of Regulation 1803.

Regulation 1802 were adopted and given retroactive effect. The proponents contended that transactions negotiated at an instate sales office, with the sales occurring outside the state, should be properly regarded as sales tax transactions, not use tax transactions. However, the proposal was to retain the character of the local tax as use tax, but directly allocate the local use tax to the out-of-state retailer's local branch office where the order was taken, rather than to the jurisdiction in which the property was used. The proposal was not adopted.

The 1996 study disclosed that allocating the tax to the sales office and away from the location of use had the effect of concentrating the tax in the hands of a few jurisdictions. The ratio of jurisdictions that would lose revenues to jurisdictions that would gain revenues under the proposal was 10:1. The study found that 47 cities and 1 county were identified as "winners," and 422 cities and 57 counties were identified as "losers." The study also noted that if the applicable 1995 local tax revenues were reallocated, San Ramon and Irvine would gain the most revenue ($3,870,490 and $2,895,638, respectively), with San Francisco and Los Angeles projected as losing the most revenue ($927,939 and $1,405,637, respectively). (See Exhibit 9 for an illustration of why a jurisdiction such as San Francisco or Los Angeles was projected as experiencing a loss under the 1996 study.)

In its April 6, 2007 submission, MSLLC restates its opinion that the specific "winners and losers" predicted under the study are misleading and should be ignored, stating:

> "The specific revenue loses… are based on a flawed 1996 study of the issue by Board [s]taff. The notion that the City of Los Angeles would lose approximately $1 MM of revenue from the proposed changes is ludicrous. That study also does not take into account the county one-quarter percent tax, which is the principal source of Bradley-Burns revenue for counties. Therefore, its specific "winners and losers" predictions are misleading and should be ignored. The counties were also badly mislead in 1996 on this issue, because they opposed the settlement proposal before the Business Taxes Committee at that time under the misapprehension that counties as a whole would be substantial net losers under it. That cannot be correct.
>
> "MSLLC also believes that the 1996 Board study is not a reliable basis for calculating the net amounts at issue under the Mass Appeal and related cases that are still pending Board hearing. The net aggregate adjustment to county pools predicted by the 1996 BOE study was approximately $13.4 MM per annum. Many of the 895 claims studied at that time involved taxpayers that are no longer operating in the claiming jurisdiction and for which no replacement claims have ever been filed. MSLLC's records indicate that only approximately 100 of those businesses are operating in those locations today."

Staff believes the methodology used in the Board's 1996 study is sound and there has been no substantiation to the contrary. It is currently the best available data that illustrates the impact of a proposal to amend the regulation as requested. Staff does agree with MSLLC, however, that determining the amounts and accuracy of the pending claims will present significant challenges for all, if the proposed changes are adopted by the Board. Staff also agrees that the 1996 study did not disclose the impact to the one-quarter county transportation local taxes caused by a redistribution of one percent tax from cities within one county to cities within another county. However, the study did note, "generally this will impact the largest losing counties, e.g., San Francisco and Los Angeles."

In its April 6, 2007 submission (see Exhibit 7, pages 17-18), MSLLC discusses its recommended use of estimates to determine the amount of local revenues that should be reallocated and notes awareness that some cities and counties will suffer negative consequences. At their request, Sales and Use Tax

Department staff met with MSLLC representatives on April 23, 2007, to discuss methods of estimating the impact of their proposal on jurisdictions. There was an understanding that the development of a new methodology would need to be based in part on available data, as well as on various estimates to make the necessary adjustments. These estimates would, in turn, need to be extracted or developed from data that is not currently captured or readily available in Board records. Staff explained that unless the Board decides to amend the regulation, staff cannot justify the administrative costs that would be incurred by dedicating time and staff resources to work local tax reallocation cases based on factual situations that staff has held would not qualify for reallocation under the current provisions of Regulation 1803.

Unfortunately, without staff working each inquiry filed by consultants and obtaining accurate information for each inquiry, neither MSLLC, staff, nor the affected jurisdictions can reasonably know the actual impact of the reallocation of revenues that would result from a retroactive application of the proposed amendments to Regulation 1803. There is also no precise method for estimating the impact of the proposed change on jurisdictions in the future. Whether the estimates are based on a projection using the 1996 study or based on the "correction process" discussed in the MSLLC April 6, 2007 submission (see Exhibit 7, pages 16-18), any projections will be based on estimates using some type of methodology.

In its submission, MSLLC also asserts that the fact that some consultants and jurisdictions chose not to file claims relating to this issue, even after the dispute became public in 1996, does not mean that MSLLC should not be committed to negotiating an estimated "pool adjustment" amount for each claim that will quantify net "corrections" and charges, including retailers no longer located in the claiming jurisdictions.

Regarding this subject, in its April 6, 2007 submission (see Exhibit 6, pages 6-7) HDL provides the following comments:

> "Proponents of retroactivity have acknowledged that a high percentage of pending cases will ultimately go unresolved because some companies will have closed down, moved, been acquired, accounting records will have been destroyed, key tax department personnel will have long since retired or otherwise moved on, etc… This is a considerable waste of Board resources and staff time to ask that thorough investigations be done on a large inventory of cases, when it [is] acknowledged at the outset that a large number of these cases will ultimately be dead ends.
>
> "The retroactive claims that are finally tracked down will be subject to appeal by the losing jurisdictions which will take additional resources and time all of which adds to the administrative fees charged to all local governments while detracting from the Board's primary goal of revenue collection.
>
> "When trying to decide the true intent of the Board Members (past or present), we should all agree upon a standard. This standard should be the Board's own written regulations, which are usually adopted with input from taxpayers, local jurisdictions and their consultants. Revisions and clarifications are an important part of the process and the Board's willingness to continually reevaluate and explore possible improvements are greatly appreciated.
>
> "However, revisions and clarifications should be requested *and pursued* [emphasis in original] in a timely fashion (not a decade after the fact), and should be applied prospectively. To do otherwise is simply unfair to all of the participants in this process (local governments, taxpayers, and Board staff) who have made a good faith effort to comply with the Board's regulations as

> *written* [emphasis in original], and have refrained from submitting or pursuing inquiries based on speculation as to their true meaning or intent."

Mr. Boyd also provides comments regarding the results of the 1996 study in his April 6, 2007 submission.

> "Staff developed in 1996, at the direction of the Board, a 'winners and losers' list for the 'mass appeal' matter of MBIA…. [As noted in the study] there are 49 'winners' and 476 'losers.' Staff advises that a conservative estimate as of today is between twice and triple the amounts subject to reallocation…. Given the tremendous difficulty to all parties involved, the conceded inaccuracy of the amounts subject to reallocation, and the fact that reallocation is a 'zero sum game,' what is the public policy urgency in applying these changes retroactively.
>
> "Page 13 of …Exhibit [7] [of the Second Discussion Paper] shows the financial impact in 1996 of the MRC (now MBIA/MSLLC) claims. …the unaudited total of these claims in 1996 was $38,394,067. If one is conservative by assuming this number is now just doubled and not tripled, it would amount to $76,788,134 today. If one further assumes that a consultant would be entitled to 25% of funds reallocated, and that all these MRC/MSLLC claims are verifiable, 25% would amount to $19,197,033…. While opinions may differ on the merits of proposed changes to Regulation 1802 and 1803, the unfairness of applying these changes retroactively is manifest."

Additional workload for the Local Revenue Allocation Unit and the Allocation Group – Staff estimates that the Board offices administering local taxes will experience additional costs if the proposed changes are adopted by the Board. The Board's Local Revenue Allocation Unit (LRAU) is responsible for the initial allocation and distribution of all local taxes including those reported on sales and use tax returns, determined from audit findings, and included in accounts receivable. As part of its duties, the unit analyzes the local tax schedules submitted with returns. The Board's Allocation Group is responsible for processing written inquiries from local jurisdictions and/or their representatives regarding questionable or disputed local tax allocations and investigates the allocations made by individual retailers as necessary.

If the proposal is adopted, the process of identifying the retailer accounts that require recoding and initiating the registration process will take approximately two years since nearly all communications will be done by mail. While the registration process is in progress, there will be a need to monitor the identified accounts to ensure that the local taxes are properly allocated in the interim registration period. (Please refer to the pro and con sections on pages 24-25 and 28-29 for more information regarding the additional costs to Board staff under Alternatives 2 and 3, respectively.)

Additionally, both LRAU and the Allocation Group are fully funded by administrative fees paid by the local jurisdictions. The increase in the personnel costs for LRAU and the Allocation Group will be factored into the next year's charges to the jurisdictions. Any uncompensated charges this year will be made up as part of the reconciliation to be performed two years from now. There is no ceiling under the Local Tax Law for the administrative fees charged to local jurisdictions and that is where any additional costs would properly be allocated. In essence, the local jurisdictions that will lose revenue resulting from the proposed change to Regulation 1803 (approximately 90% of the jurisdictions), will not only lose funds, but will also pay higher administrative fees.

In its April 6, 2007 submission (see Exhibit 7, page 16), MSLLC questions the Allocation Group's staff cost estimate on a going forward basis given the proposal is adopted by the Board. The Allocation Group

estimates that there would be approximately 1,250 new claims a year under the proposal. MSLLC strongly suggests the following:

> "Awaiting some experience before budgeting for such an increase in total workload would appear prudent. Also, most of the new inquiries of this nature will no longer require the endless factual investigations and resulting inaccuracies for uninvestigated types of contracts of the same taxpayer that exists under the current facts and circumstances policy. Even if a number of new submissions were to materialize, the time required to investigate each should be radically reduced."

Definition of local participation and place of business of the retailer – In its proposed amendments to Regulation 1802, MSLLC proposes a paragraph be added to subdivision (a) to discuss the basics of "participation" for the purposes of Regulations 1802 and Regulation 1803. MSLLC proposes that the paragraph be included in Regulation 1802 rather than Regulation 1803. As reflected in Exhibit 3, MSLLC provides the following paragraph:

> "Normally, the place of business where participation occurs is the place where the order is taken or the sales contract is negotiated, or, in the case of out-of-state orders or negotiations, the place of business in this state where shipment occurs. Where the principal negotiations occur in state, it is immaterial that the order must be forwarded elsewhere for acceptance, approval of credit, shipment, or billing. For the purposes of this regulation, an employee's activities will be attributed to the place of business out of which he or she works."

With assistance and input from staff, the City of San Jose proposes that the following definition of "participation," as reflected in Exhibit 4, be included as part of their proposed amendments to Regulation 1803.

"Local Participation" means and includes the following activities occurring in California:

(1) Taking an order for the retailer's tangible personal property at a place of business of the retailer.

(2) Negotiating the sale or purchase of the retailer's tangible personal property at a place of business of the retailer.

(3) Delivering, or assisting in the delivery of, the retailer's tangible personal property when the property is fulfilled from in-state inventories of the retailer."

The City of San Jose also proposes the following definition for "place of business of the retailer" be included as part of the proposed amendments to Regulation 1803. The definition is intended to limit the business locations of the retailer that participate in the sales transaction to those that are permanent and where sales negotiations regularly take place. The definition is also intended to exclude "rent-an-office" locations with only an answering service and mail pickup, or rented conference rooms.

"Place of Business of the Retailer" means and includes:

"A permanent location owned and or operated by the retailer where sales are customarily negotiated with customers. For example, a sales office, storefront, or outlet operated by the retailer where sales are negotiated or orders are taken would be a place of business of the retailer.

"For the purposes of subdivisions (a) and (b), a place of business of the retailer would not include an administrative office, a location where the activities are limited to processing credit

> applications, or the homes or offices of agents or representatives of the retailer, including a location in which the retailer does not have a proprietary interest."

The City of San Jose also suggested that language be added to the regulation to make it clear that the proposed changes would not apply to lease transactions.

While staff believes the City of San Jose's definitions of participation and place of business of the retailer will provide clarification and guidance for determining whether local sales or use tax applies to the type of transactions under discussion, MSLLC's "definition" of participation is believed vague and unclear.

Although the MSLLC proposed paragraph refers to the activities of taking an order, negotiating the sale, and delivering the property sold, the "definition" does not clearly state that these activities represent participation for the purposes of the determination of the character of the local tax. The proposed language indirectly refers to the activities as examples of where participation *normally* occurs, i.e., place of business of the retailer, which under the definition is somewhat open-ended. Such open-ended and vague language could result in a potentially ambiguous interpretation of what is considered participation for the purposes of determining whether local sales or use tax applies to a transaction.

In addition, MSLLC's inclusion of the "definition" of participation in Regulation 1802, rather than Regulation 1803, would generally result in confusion and an amended regulation that is unable to "stand on its own." Instead of Regulation 1803 providing clear guidance regarding the determination of whether local sales or use tax applies to a transaction, one will have to refer to Regulation 1802 for an explanation of what type of activities qualify as participation for the purposes of determining the character of the tax. This would be contrary to the intent of the regulation. As stated previously, the provisions of Regulation 1802(a) are intended for determining *where* the local sales tax should be allocated once it is determined that sales tax applies, not for determining whether local sales or use tax applies to a transaction.

To assist in its development of proposed regulatory provisions that would be consistent and clear, staff suggested language to MSLLC for amending Regulation 1803. Like that proposed by the City of San Jose (with assistance from staff), the suggested language defined local participation and place of business of the retailer for the purposes of Regulation 1803. To date, MSLLC has not expressed agreement with the suggestions offered.

Regulation 1803 and lease transactions – Regarding lease transactions, MSLLC proposed the following language be added to Regulation 1803, subdivision (d):

> "The clarifying amendments to Regulations 1802 and 1803 shall not create any inference with regard to how local tax revenues from leasing transactions should be reported by taxpayers and distributed to participating jurisdictions. Therefore, any inquiries filed under section 7209 with regard to leasing transactions shall be resolved as if these amendments had not been adopted."

Staff interprets MSLLC's statement to mean that any open inquiries regarding leases (continuing sales and purchases) should be handled under the current provisions of Regulation 1803. However, it is unclear whether MSLLC is stating that the proposed amendments to Regulation 1803 will also apply to future lease transactions effectively changing them from use tax transactions to sales tax transactions, with local tax lease revenues being allocated to the jurisdictions where the California offices that participated in the negotiations for the leases are located, not where the lessee is located.

In his April 5, 2007 letter, Mr. Dave McPherson, Deputy Director, Finance Department, representing the City of San Jose (see Exhibit 6, page 27), also asks for clarification regarding any intent by MSLLC to include lease transactions in the proposed amendments to Regulation 1803. In order to "eliminate any potential loopholes or confusion in Regulation 1803," the City of San Jose requests that the proposed language for amending Regulation 1803 clearly define that any change does not apply to lease transactions.

VI. Alternative 1 - Staff Recommendation

A. Description of Alternative 1

Staff recommends that the Board make no change to Regulation 1803 or Regulation 1802. Staff believes that Regulation 1803 correctly interprets RTC sections 7202 and 7203 to provide that when the state sales tax applies to a transaction, local sales tax also applies unless there is a statutory exemption from the local sales tax. When state use tax applies to a transaction, local use tax also applies. The Local Tax Law was always intended to follow the State Tax Law. The provisions of RTC sections 7202 and 7203 that a reference to the jurisdiction imposing the local tax must generally be substituted for that of "the state" was not intended to provide, nor ever interpreted by the Board as meaning, that the Local Tax Law be interpreted separate and apart from the State Tax Law, with respect to the activity that is being taxed.

Staff's recommendation is supported by the California Retailers Association (CRA), HDL, Mr. Boyd, the City of Corning, City of Lake Forest, City of Encinitas, City of Mountain View, City of San Marcos, City of Paso Robles, Orange County, and the California State Association of Counties.

In its April 5, 2007 submission, CRA reiterates its opposition to the changes proposed by MSLLC. CRA believes the proposed changes to Regulation 1803 would be very problematic for retailers. As explained in their letter,

> "…it is not always clear where a particular sale is 'negotiated.' There are variables that can come into play to make this determination. For example, if a chain store does not have a particular item in stock, the clerk at that store will search for the item in the company's inventory at other stores. Very often, the desired item is found in a store outside California. The clerk then relays the customer's credit card information and mailing address to a clerk at the store outside California. The out-of-state store then rings up the sale and ships the item directly to the customer in California. It would be virtually impossible for retailers to program their computers/POS systems in a way to properly capture this information to determine which local tax to apply. Even if retailers could find a way to build that ability into their systems, basing the tax allocation at the negotiation point would mean a massive programming effort just for California. Furthermore, forcing sales associates to manually make determinations and tax calculations on every 'send' sale is simply a non-starter – it will lead to numerous instances where the incorrect rate of tax is collected."

In its April 6, 2007 submission (see Exhibit 6, pages 6-7), HDL also states their opposition to the MSLLC proposal to amend Regulation 1803 on a retroactive basis. Although HDL does support the direct situs allocation of local sales and use tax, particularly when a legitimate claim can be made that the local agency receiving the funds is the one providing the public services to the business, they have reservations regarding the proposed amendments to Regulation 1803. HDL states the following:

> "…we have serious reservations about the proposed re-interpretation of Regulation 1803, particularly in the current environment where sales tax sharing agreements are becoming the determining factor in where a 'place of sale' is located. Further lowering the bar as to what constitutes a 'place of sale' or in-state 'participation' will only fuel growth in this practice, and in the burgeoning industry set up to solicit government bidding on tax kickback in exchange for allocation of sales and use tax revenues.
>
> "These agreements are rebating 50% or more of public tax dollars to the private sector, and often corrupt (rather than encourage) the relationship between tax allocation and service burden. The possibility of direct allocation of local tax on shipments from out of state is worthy of future review but only in context with potential solutions to the problems that it would exacerbate."

In its April 6, 2007 electronic correspondence (see Exhibit 6, page 15), Mr. Robert F. Locke, Finance & Administrative Services Director for the City of Mountain View (Mr. Locke), expresses his opposition to the proposed reinterpretation of Regulation 1803 and especially its retroactive application. Mr. Locke believes it is "bad public policy… to put a majority of sales tax receiving public agencies in California through the pain of returning sales tax revenues that have already been spent for the windfall gain of a small, underserved group of public agencies, and their consultants [emphasis in original], because of a reinterpretation of [the] regulation."

Mr. Chris Norby, Chairman of the Board, Supervisor, Fourth District, from Orange County provides, in part, the following comments regarding a reinterpretation of Regulation 1803:

> "As the lowest urban property tax county in California, the County of Orange is particularly susceptible financially to changes in the allocation of sales and use taxes. The notion of a retroactive reallocation of sales and use taxes is even more disturbing. We are challenged on an annual basis to identify and secure revenues to provide vital County services to more than three million residents and scores of businesses. A thorough financial analysis of the potential impact of any rule change should be thoroughly explored and examined in a public setting before moving forward on any changes to the regulations."

B. Pros of Alternative 1

- Retains the current provisions of Regulation 1803 that require the character of the local sales or use tax to be the same as the character of the state sales or use tax.
- Is supported by the applicable California statutes and accurately reflects the Board's long-standing interpretations, policies, and procedures.
- Is consistent with the intent of the Legislature when it enacted the State and Local Tax Laws.
- When the sales occur outside the state, cities will continue to benefit proportionately when the property is delivered to customers in other cities within the county besides their own.

C. Cons of Alternative 1

- Does not accomplish the long-term or short-term goals of the proponents to change the character of the tax.

D. Statutory or Regulatory Change for Alternative 1

None required.

E. Operational Impact of Alternative 1

None.

F. Administrative Impact of Alternative 1

1. Cost Impact

None.

2. Revenue Impact

None. See Revenue Estimate, Exhibit 1.

G. Taxpayer/Customer Impact of Alternative 1

None. Continues the status quo.

H. Critical Time Frames of Alternative 1

None

VII. Alternative 2 – MSLLC Proposal

A. Description of Alternative 2

Amends Regulation 1803, on a retroactive basis, to apply local sales tax to sales of products shipped into California, with title passing outside the state, whenever there is local participation in the sales transaction. Local sales tax would apply even though the state use tax, not the state sales tax, may apply to the same transaction (see Exhibit 2). For consistency and regulatory support, MSLLC also proposes to amend Regulation 1802, subdivision (a), on a retroactive basis, to remove any reference that title is to pass in California, as reflected in Exhibit 3. The proposed amendments also define participation under Regulation 1802 and provide a transition rule for leases under Regulation 1803.

The proposed amendments are supported by the City of San Ramon, City of San Diego, City of San Bernardino, City of Long Beach, City of Los Angeles, City of Sacramento, and Mr. Robert E. Cendejas, Attorney at Law, representing the City of Ontario.

As part of its April 6, 2007 submission, MSLLC provided proposed language for amending Regulations 1803 and 1802 (see Exhibit 2 and 3, respectively), which MSLLC believes is necessary for consistency and regulatory support. MSCCL also provided the following comments:

> "The proposed amendments to both Regulations 1802 and 1803 are intended to conform them to the agreement reached in March of 1956 that if a local place of business 'participates' in a sale by taking the order or negotiating the sale, a 'conclusive presumption' would apply that the sale occurred there. The only exception was to be that the rule governing where a sale occurs for transportation charge inclusion purposes would also apply in calculating Bradley-Burns taxes, as required by RTC [s]ection 7205 (a)…. The proposal for Regulation 1802 (a)(3) eliminates only the wording that added an in-state-title-passage test that was contrary to RTC

> [s]ection 7202 and the local ordinances which do not incorporate the 'in this state' language that appears in RTC [s]ection 6051, the state sales tax statute.
>
> "At the second interested party meeting, Board [s]taff suggested only that: i.) the current definition of 'participation' used in practice be more specific in the regulation draft to prevent insubstantial activities from meeting that definition; and ii.) leasing transactions be excluded from being affected one way or the other by these clarifications. Language and a transition rule have been added to the clarifying amendments provided in Exhibit D [see Exhibits 2 and 3, respectively] as suggested by [s]taff."

Staff reviewed MSLLC's proposed amendments for Regulations 1803 and 1802 (Exhibits 2 and 3, respectively) and believes the language does not contain the specific definitions believed necessary to provide regulatory guidance. As staff has discussed previously, a regulation should be able to "stand on its own," meaning that the reader should be able to find guidance regarding the type of activities in California that are considered "local participation" for the purposes of imposing the local sales tax from reading Regulation 1803. Staff does not believe the reader should have to refer to Regulation 1802 for a definition of "participation," as proposed by MSLLC. Although MSLLC does not agree that title must transfer in California for local sales tax to apply to a transaction, it does agree that local participation on the part of the retailer must occur in California for the local sales tax to apply.

B. Pros of Alternative 2

- Furthers the policy of distributing local sales tax to the extent possible, to the "point of sale."
- Returns local tax revenues to jurisdictions that provide the infrastructure for the retailers.
- Proponents believe it is consistent with the intent of the Legislature.
- Proponents believe the amendments will make the regulations valid.
- Believed by proponents to correct inequities in effect for over 50 years.

C. Cons of Alternative 2

- The retroactive application of this proposal would:
    - ♦ Revise the liability for previous sales.
    - ♦ Result in reallocation of significant amounts of local tax revenues that were distributed over 12 years ago (and in some cases, over 20 years ago).
    - ♦ Result in a potentially significant monetary hardship and budgetary concerns to losing jurisdictions.
    - ♦ Result in higher administrative fees to all jurisdictions, including those that will end up losing funds in the reallocation process.
- Results in revenue shifts among different counties, not just within a county.
- "Divorces" the local tax from the state tax.
- Opponents consider it contrary to law.

- Changes application of tax after over 50 years of precedent.

D. Statutory or Regulatory Change for Alternative 2

Proposal requires that Regulations 1803 and 1802 be amended.

E. Operational Impact of Alternative 2

The Local Revenue Allocation Unit and the Allocation Group will be directly impacted by the proposed change. LRAU will experience a significant increase in workload because of the proposed amendments. The Allocation Group estimates an additional 1250 inquiries per fiscal year could be filed under the proposed amendments. MSLLC, however, believes the proposed amendments will decrease rather than increase staff workload as staff will have fewer requirements to verify under the simplified provisions.

Since the proposed amendments will result in the specified transactions as being subject to local sales tax along with the state use tax and any applicable district use tax, there may need to be a change in auditing procedures and verification procedures. This may require additional time on the part of out-of-state auditors in verifying transactions.

Staff will notify taxpayers of the amendments to Regulation 1803 through an article in the Tax Information Bulletin (TIB). Manuals, returns, staff training materials, and pamphlets will also need revision.

F. Administrative Impact of Alternative 2

1. Cost Impact

- For LRAU, there are approximately 1500 accounts (100 are accounts with local tax of $20,000 and above and the rest report less than this amount per reporting period). If the proposal is adopted, the change to current policy will require the LRAU to identify affected accounts, all of which are out-of-state accounts, through a survey process. This will require staff to determine the accounts that need to be surveyed, to obtain the survey results, and to initiate registration changes by the Board's out-of-state district office. In most cases, this will require a change in registration for many of these accounts from a "SC" account (holder of a *Certificate of Registration – Use Tax*) to a "SR S" account (seller's permit for one sales/order location instate) or a "SR Z" account (two or more sales/order locations in state).

    - ♦ The process of identifying the retailer accounts that require recoding and initiating the registration process will take approximately two years since nearly all communications will be done by mail. While the registration process is in progress, there will be a need to monitor the identified accounts to ensure that the local taxes are properly allocated in the interim registration period.

    - ♦ This will require one (1) Tax Technician II (permanent position) to properly code accounts and make registration chang**e**s for new accounts, as well as the on-going process. The unit will also require one (1) Tax Auditor (permanent position) to work cases that develop from accounts that do not comply with the new requirements, which is expected to amount to 255 of the total accounts identified. Combined impact is estimated at **$149,000 for the first year**, including the necessary equipment.

- ♦ For the second year and the following years, staff costs are estimated at **$128,000 per year.**

If, through a future Budget Change Proposal, these costs are approved by the Board, the costs will be passed on to local jurisdictions as costs for administering the local tax. However, it should also be noted that an approval for additional staff would ensure the timely completion of the additional workload, as well as the timely disbursement of funds to jurisdictions.

- For the Allocation Group, along with the 40 cases currently in inventory, there are approximately 1,040 to 1,390 cases under appeal that will qualify for retroactive treatment if the proposal is adopted. The hours estimated to investigate and process these cases are between 5,200 to 6,950 hours. If, through a future Budget Change Proposal, these costs are approved by the Board, the costs will be passed on to local jurisdictions as costs for administering the local tax.

  - ♦ Based on the yearly hours per staff position of 1,800 hours, investigating and processing the cases currently under appeal will require three (3) to four (4) one-year limited-term positions (depending on the number of open inquiries) at a cost of **$600,000** to **$802,500** including the necessary equipment for the positions.

  - ♦ The Allocation Group staff costs for the second year and the following years are estimated at **$339,500 per year**, which includes 3.5 permanent positions at the Associate Tax Auditor level to handle an estimated 1,250 inquiries per fiscal year to be filed if the proposed change is made.

2. Revenue Impact

None. See Revenue Estimate, Exhibit 1

G. Taxpayer/Customer Impact of Alternative 2

Since the proposed amendments will apply retroactively, affected retailers will be required to apply the provisions of the regulation to past as well as future transactions. This will create a hardship for many retailers. As stated by HDL in their April 5, 2007 submission, "retroactivity would require that taxpayers who are subjects of the claims research business activities and amend quarterly sales tax returns and schedules going back twelve years or more. This is an unnecessary and unfair request of companies who made a good faith effort to comply with the Board's regulations and reporting guidelines that were being administered at the time."

Further, out-of-state retailers who maintain places of business in California that participate in the sales transaction, will be required to report and remit California local sales taxes on their sales of products to California customers, even though such products are shipped into California, with title passing outside the state. The out-of-state retailers will also be required to report and collect state use taxes and the applicable district use taxes on those same transactions. The out-of-state retailer will be liable for the payment of the local sales tax even though the California customer is ultimately liable for the state and district use taxes.

On a going forward basis, the retailers may require revised recordkeeping, including new software, for allocating the tax. Retailers will also have to track each sales location and keep records on where the negotiations occurred or the orders were taken. That is, they will have to separately account for

local sales transactions from those subject to state and district use taxes. There may also be a need for additional Board schedules, as well as sub-permits for locations where the orders are taken or negotiated, that are not currently registered with the Board.

H. Critical Time Frames of Alternative 2

Given approval is received from the Office of Administrative Law, staff, retailers, and all other affected parties will have a limited period to implement the amended rules and policies. Considering the age of the pending inquiries, staff will also have a limited amount of time to work the inquiries.

VIII. Alternative 3 – League and City of San Jose Proposal

A. Description of Alternative 3

Amends Regulation 1803, operative July 1, 2008, to apply local sales tax to sales of products shipped into California, with title passing outside the state, whenever there is local participation in the sales transaction. Local sales tax will apply even though the state use tax, not the state sales tax, may apply to the same transaction, as reflected in Exhibit 4. For consistency and regulatory support, also amends Regulation 1802, subdivision (a), operative July 1, 2008, to remove any reference that title is to pass in California, as reflected in Exhibit 5.

The proposal to amend Regulation 1803 on a prospective basis rather than a retroactive basis is supported by the League.

In its April 6, 2007 submission, the League proposes that the proposal by MSLLC to amend Regulation 1803 be implemented, but on a prospective rather than a retroactive basis. The League provides the following comments:

> "The [Revenue and Taxation Policy] Committee supported this approach as a way to implement the League's existing policy, which favors situs-based allocation as the appropriate method to match local revenues with the local impact. However, the Committee did not [emphasis in original] take a position on application of the amendments to existing claims on a retroactive basis. During the Committee meeting, many questions arose as to what the financial impact of retroactivity would be on California cities and how to enact a reasonable reallocation method. The Committee felt that without this important information on the fiscal impact, no position on retroactivity could be taken.
>
> "The League requests that Board staff undertake an analysis showing the amount of money to be reallocated and the number of jurisdictions affected by these proposed amendments. We believe that this analysis should be shared with all interested parties for their feedback no later than a few weeks prior to the Business Taxes Meeting to be held on May 31, 2007, and certainly prior to any decision by the BOE on the issue of retroactivity."

As was previously discussed, without working each inquiry, Board staff is unable to provide information regarding the impact of a retroactive application. Although Board staff may provide an estimate of the amount of revenue that can be expected to be reallocated, its actual impact is unknown at this time.

Nonetheless, it would appear reasonable that if transactions such as those under discussion were allocated on a site-specific basis to sales office locations, as opposed to the jurisdictions of use, there

would be a concentration of revenues in a fractional number of jurisdictions. As noted in the 1996 study, the concentration for those transactions would be 10:1; that is, for every dollar gained by a jurisdiction which had a net gain, ten other jurisdictions would lose ten cents each. Although the study proved nothing with respect to any specific jurisdiction if the proposed changes were on a prospective basis, it does suggest, however, that large cities such as Los Angeles and San Francisco would probably be net losers under a prospective change. This suggests that those jurisdictions which receive the most money now would be net losers of revenue under the proposal, although the losses would be small, measured on a percentage basis of revenues distributed to those jurisdictions.

With the assistance of staff in developing proposed regulatory language, the City of San Jose proposes an amendment to Regulation 1803 to provide that sales of property shipped into California from outside the state, with title passing outside the state, are subject to local sales tax, not local use tax, when there is local participation in the sales transaction. In addition to having a prospective date, the language proposed by the City of San Jose is different from the language proposed by MSLLC. The City of San Jose's proposed regulatory language, including proposed definitions for local participation and the place of business of the retailer, are reflected in Exhibit 4.

Although staff opposes the proposed amendments to Regulations 1802 and 1803, staff believes that the prospective effect of the amendments proposed in Alternative 3 are less problematic to implement than the retroactive amendments proposed in Alternative 2.

B. Pros of Alternative 3

- Furthers the policy of distributing local sales tax, to the extent possible, to the "point of sale."
- Implements the regulatory amendments on a going forward basis rather than retroactively.
- The operative date of July 1, 2008 provides less of an impact on affected retailers, losing jurisdictions, and staff than a retroactive amendment will.

C. Cons of Alternative 3

- Opponents consider it contrary to law.
- "Divorces" the local tax from the state tax.
- Results in revenue shifts among different counties, not just within a county.
- Changes application of tax after over 50 years of precedent.

D. Statutory or Regulatory Change for Alternative 3

Proposal requires that Regulations 1803 and 1802 be amended.

E. Operational Impact of Alternative 3

The Local Revenue Allocation Unit and the Allocation Group will be directly impacted by the proposed change. LRAU will experience a significant increase in workload because of the proposed amendments. The Allocation Group estimates an additional 1250 inquiries per fiscal year could be filed under the proposed amendments. MSLLC, however, believes the proposed amendments will decrease rather than increase staff workload as staff will have fewer requirements to verify under the simplified provisions.

Since the proposed amendments will result in the specified transactions as being subject to local sales tax along with the state use tax and any applicable district use tax, there may need to be a change in auditing procedures and verification procedures. This may require additional time on the part of out-of-state auditors in verifying transactions.

The proposed changes will also require taxpayer notification, as well as revision to manuals, returns, schedules, staff training materials, and pamphlets. These costs were not estimated, as this updating is considered routine when a regulation is revised.

F. Administrative Impact of Alternative 3

1. Cost Impact

- For LRAU, there are approximately 1500 accounts (100 are accounts with local tax of $20,000 and above and the rest report less than this amount per reporting period). If the proposal is adopted, the change to current policy will require the LRAU to identify affected accounts, all of which are out-of-state accounts, through a survey process. This will require staff to determine the accounts that need to be surveyed, to obtain the survey results, and to initiate registration changes by the Board's out-of-state district office. In most cases, this will require a change in registration for many of these accounts from a "SC" account (holder of a *Certificate of Registration – Use Tax*) to a "SR S" account (seller's permit for one sales/order location instate) or a "SR Z" account (two or more sales/order locations in state).

    - ♦ The process of identifying the retailer accounts that require recoding and initiating the registration process will take approximately two years since nearly all communications will be done by mail. While the registration process is in progress, there will be a need to monitor the identified accounts to ensure that the local taxes are properly allocated in the interim registration period.

    - ♦ This will require one (1) Tax Technician II (permanent position) to properly code accounts and make registration changes for new accounts, as well as the on-going process. The unit will also require one (1) Tax Auditor (permanent position) to work cases that develop from accounts that do not comply with the new requirements, which is expected to amount to 255 of the total accounts identified. Combined impact is estimated at **$149,000 for the first year**, including the necessary equipment.

    - ♦ For the second year and the following years, staff costs are estimated at **$128,000 per year.**

  If, through a future Budget Change Proposal, these costs are approved by the Board, the costs will be passed on to local jurisdictions as costs for administering the local tax. However, it

should also be noted that an approval for additional staff would ensure the timely completion of the additional workload, as well as the timely disbursement of funds to jurisdictions.

- For the Allocation Group, although the Allocation Group would not be directly involved in the "mass appeal" inquiries under a prospective application, staff estimates there would be 1,250 inquiries filed per fiscal year under the proposed change. This would require 3.5 permanent positions at the Associate Tax Auditor level with an estimated cost for the first year of **$374,500**, including the required equipment. For the second year and the following years, staff costs are estimated at **$339, 500 per year.** If, through a future Budget Change Proposal, these costs are approved by the Board, the costs will be passed on to local jurisdictions as costs for administering the local tax.

2. Revenue Impact

None. See Revenue Estimate, Exhibit 1.

G. Taxpayer/Customer Impact of Alternative 3

Beginning July 1, 2008, out-of-state retailers who maintain places of business (as defined) in California that participate in the sales transaction, will be required to report and remit California local sales taxes on their sales of products to California customers, even though such products are shipped into California, with title passing outside the state. The out-of-state retailers will also be required to report and collect state use taxes and the applicable district use taxes on those same transactions. The out-of-state retailer will be liable for the payment of the local sales tax even though the California customer is ultimately liable for the state and district use taxes.

On a going forward basis, the retailers may require revised recordkeeping, including new software for allocating the tax. Retailers will also have to track each sales location and keep records on where the negotiations occurred or the orders were taken. That is, they will have to separately account for local sales transactions from those subject to state and district use taxes. There may also be a need for additional Board schedules, as well as sub-permits for locations where the orders are taken or negotiated, that are not currently registered with the Board.

H. Critical Time Frames of Alternative 3

The City of San Jose proposes an operative date of July 1, 2008, to allow adequate time to notify taxpayers and staff of the change, to issue sub-permits to affected retailers, and to make the necessary changes to schedules and returns. Implementation will begin 30 days following approval of the regulation by the State Office of Administrative Law.

Preparer/Reviewer Information

Prepared by: Tax Policy Division
Current as of: May 17, 2007

BOARD OF EQUALIZATION
REVENUE ESTIMATE

Proposed amendments to Regulation 1803, *Application of Tax*

Alternatives

Alternative 1 - Staff Recommendation

Staff recommends that the Board make no change to Regulation 1803. The current provisions of Regulation 1803 that require the character of the local sales or use tax to be the same as the character of the state sales or use tax are supported by applicable statutes and reflect Board interpretations, policies, and procedures that have been in place for more than fifty years. Adopting a proposal that would "divorce" the local tax from the state tax would reverse well-settled law adopted and followed by prior Boards, as well as reversing long-standing interpretations, policies and procedures.

The California Retailers Association, the HdL Companies, Mr. Douglas R. Boyd, Sr., Attorney at Law (Mr. Boyd), the City of Corning, City of Lake Forest, City of Encinitas, City of Mountain View, City of San Marcos, City of Paso Robles, Orange County, and the California State Association of Counties support the recommendation to make no changes to Regulation 1803.

Alternative 2

As proposed by Mr. Albin C. Koch, MuniServices LLC (MSLLC), and supported by the City of San Ramon, City of San Diego, City of San Bernardino, City of Long Beach, City of Los Angeles, City of Sacramento, and Mr. Robert E. Cendejas, Attorney at Law (Mr. Cendejas), representing the City of Ontario, amend Regulation 1803 on a retroactive basis to apply local sales tax to sales of products shipped into California, with title passing outside the state, whenever there is local participation in the sales transaction. Local sales tax would apply even though the state use tax, not the state sales tax, may apply to the same transaction. For consistency, MSLLC also proposes that Regulation 1802*, Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes*, subdivision (a) be amended, on a retroactive basis.

Alternative 3

As proposed by the City of San Jose, amend Regulation 1803, operative July 1, 2008, to apply local sales tax to sales of products shipped into California, with title passing outside the state, whenever there is local participation in the sales transaction. For consistency, this alternative also proposes that Regulation 1802*,* subdivision (a) be amended operative July 1, 2008. The proposed amendments to Regulations 1803 and 1802 are attached as Exhibits 4 and 5, respectively.

The proposal to amend Regulation 1803 on a prospective rather than a retroactive basis is supported by the Revenue and Taxation Committee of the League of California Cities (League).

Background, Methodology, and Assumptions

Alternative 1:

Alternative 1 would not have any revenue impact since it makes no changes to Regulation 1803.

Alternative 2:

There is nothing in the proposed amendments to Regulation 1802 and Regulation 1803 that would either increase or decrease revenues because the proposals define rules for the allocation of existing local sales and use tax receipts. There would, however, be a shift of revenues between local jurisdictions. Under Alternative 2 this shift in revenues would be retroactive as well as prospective.

Alternative 2:

There is nothing in the proposed amendments to Regulation 1802 and Regulation 1803 that would either increase or decrease revenues because the proposals define rules for the allocation of existing local sales and use tax receipts. There would, however, be a shift of revenues between local jurisdictions. Under Alternative 3 this shift in revenues would be prospective only.

Revenue Summary

Alternative 1 will not impact total revenues.

Alternative 2 will not impact total revenues, but will result in a shift of revenues between local jurisdictions.

Alternative 3 will not impact total revenues, but will result in a shift of revenues between local jurisdictions.

Preparation

This revenue estimate was prepared by David E. Hayes, Jr., Research and Statistics Section, Legislative and Research Division. This revenue estimate was reviewed by Mr. Jeff McGuire, Tax Policy Division Manager, Sales and Use Tax Department. For additional information, please contact Mr. Hayes at (916) 445-0840.

Current as of May 16, 2007

Regulation 1803. APPLICATION OF TAX.

(a) SALES TAX.

(1) IN GENERAL. Except as stated below, in any case in which state sales tax is applicable, state-administered Bradley-Burns uniform local sales tax is also applicable, if the place of sale is in a county imposing a state-administered local tax. ~~In any case in which state sales tax is inapplicable, state-administered local sales tax is also inapplicable.~~ ~~Thus,~~ If the place of sale as defined in Regulation 1802 is in a county having a state-administered local tax, the local sales tax shall apply whether or not the state use tax applies because ~~if~~ title to the property sold passes or is deemed to pass ~~to the purchaser~~ at a point outside this state~~, state-administered local sales tax does not apply regardless of participation in the transaction by a California retailer~~. As explained in paragraphs (b) and (c), the local use tax may apply if Regulation 1802 provides that the place of sale is not in a county or city having a state-administered local tax. If so, the retailer is required to collect the use tax and pay it to the board.

Gross receipts from sales of tangible personal property subject to the local tax shall include delivery charges, when such charges are subject to the state sales or use tax.

(2) EXCEPTION.

State-administered local sales tax does not apply to certain sales of tangible personal property to operators of aircraft to be used or consumed principally outside the county in which the sale is made if such property is to be used or consumed directly and exclusively in the use of the aircraft as common carriers of persons or property under the authority of the laws of the State of California, the United States, or any foreign government. On and after July 1, 1972, for county tax purposes this exemption is limited to 80 percent of the county tax.

(b) USE TAX. State-administered local use tax applies if the purchase is made from a retailer on or after the effective date of the local taxing ordinance and the property is purchased for use in a jurisdiction having a state-administered local tax and is actually used there, provided any one of the following conditions exist:[1]

(1) ~~Title to the property purchased passes to the purchaser at a point outside this state;~~The place of sale determined in accordance with Regulation 1802 is not in this state;

(2) The place of sale determined in accordance with Regulation 1802 is in this state but not in a jurisdiction having a state-administered local tax;

(3) The place of sale is in a jurisdiction having a state-administered local tax and there is an exemption of the sale of the property from the sales tax but there is no exemption of the use of the property from the use tax; or

(4) The property is purchased under a valid resale certificate.

State-administered local use tax does not apply to the storing, keeping, retaining, processing, fabricating or manufacturing of tangible personal property for subsequent use solely outside the state or for subsequent use solely in a county not imposing a local use tax.

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[1] The proposed amendments to subdivisions (b) and (d) submitted by MSLLC on April 6, 2007, are superseded by the proposed amendments reflected in this exhibit, submitted by MSLLC on May 1, 2007.

(c) COLLECTION OF USE TAX BY RETAILERS. Retailers engaged in business in this state and making sales of tangible personal property, the storage, use or other consumption of which is subject to a state-administered local use tax, are required to collect the tax from the purchaser. It is immaterial that the retailer might not be engaged in business in the particular county or city in which the purchaser uses the property.

Retailers who are not engaged in business in this state may apply for a Certificate of Registration - Use Tax. Holders of such certificates are required to collect tax from purchasers, give receipts therefor, and pay tax to the board in the same manner as retailers engaged in business in this state.

As used in this regulation, the term "Certificate of Registration - Use Tax" shall include Certificate of Authority to Collect Use Tax issued prior to September 11, 1957.

(d) LEASES. If a lease is a continuing sale, or a continuing purchase, for the purposes of state tax, it shall be a continuing sale, or a continuing purchase, for the purposes of local tax. If a lease is neither a continuing sale nor a continuing purchase for the purposes of state tax, it shall be neither a continuing sale nor a continuing purchase for the purposes of local tax.

No Impact on Leasing Transactions

The clarifying amendments to Regulations 1802 and 1803 shall not create any inference with regard to how local tax revenues from leasing transactions should be reported by taxpayers and distributed to participating jurisdictions. Therefore, any inquiries filed under section 7209 with regard to leasing transactions shall be resolved as if these amendments had not been adopted.

Regulation 1802. PLACE OF SALE AND USE FOR PURPOSES OF BRADLEY-BURNS UNIFORM LOCAL SALES AND USE TAXES.

Reference: Sections 6012.6, 6015, 6359, 6359.45, 7202, 7203.1, 7204.03 and 7205, Revenue and Taxation Code.

(a) IN GENERAL.

(1) RETAILERS HAVING ONE PLACE OF BUSINESS. For the purposes of the Bradley-Burns Uniform Local Sales and Use Tax Law, if a retailer has only one place of business in this state, all California retail sales of that retailer in which that place of business participates occur at that place of business unless the tangible personal property sold is delivered by the retailer or his or her agent to an out-of-state destination, or to a common carrier for delivery to an out-of-state destination.

(2) RETAILERS HAVING MORE THAN ONE PLACE OF BUSINESS.

(A) If a retailer has more than one place of business in this state but only one place of business participates in the sale, the sale occurs at that place of business.

(B) If a retailer has more than one place of business in this state which participate in the sale, the sale occurs at the place of business where the principal negotiations are carried on. I~~f this place is the place where the order is taken, it is immaterial that the order must be forwarded elsewhere for acceptance, approval of credit, shipment, or billing. For the purposes of this regulation, an employee's activities will be attributed to the place of business out of which he or she works.~~

(3) Participation

Normally, the place of business where participation occurs is the place where the order is taken or the sales contract is negotiated, or, in the case of out-of-state orders or negotiations, the place of business in this state where shipment occurs. Where the principal negotiations occur in state, it is immaterial that the order must be forwarded elsewhere for acceptance, approval of credit, shipment, or billing. For the purposes of this regulation, an employee's activities will be attributed to the place of business out of which he or she works.

(~~3~~4) PLACE OF PASSAGE OF TITLE IMMATERIAL. ~~If title to the tangible personal property sold passes to the purchaser in California, i~~It is immaterial that title to the tangible personal property sold passes to the purchaser at a place outside of the local taxing jurisdiction in which the retailer's place of business is located, or that the property sold is never within the local taxing jurisdiction in which the retailer's place of business is located.

Regulation 1803. APPLICATION OF TAX.

(a) SALES TAX.

(1) IN GENERAL. Except as stated below, in any case in which state sales tax is applicable, state-administered Bradley-Burns uniform local sales tax is also applicable, if the place of sale as defined in Regulation 1802, is in a county imposing a state-administered local tax. Except as stated in subdivision (a)(3)(B), i~~I~~n any case in which state sales tax is inapplicable, state-administered local sales tax is also inapplicable. ~~Thus, if title to the property sold passes to the purchaser at a point outside this state, state-administered local sales tax does not apply regardless of participation in the transaction by a California retailer. As explained in paragraphs (b) and (c), the use tax may apply. If so, the retailer is required to collect the use tax and pay it to the board.~~

Gross receipts from sales of tangible personal property subject to the local tax shall include delivery charges, when such charges are subject to the state sales or use tax.

(2) DEFINITIONS. For the purposes of subdivision (a) and (b), the following definitions shall apply.

(A) "Local Participation" means and includes the following activities occurring in California:

(1) Taking an order for the retailer's tangible personal property at a place of business of the retailer.

(2) Negotiating the sale or purchase of the retailer's tangible personal property at a place of business of the retailer.

(3) Delivering, or assisting in the delivery of, the retailer's tangible personal property when the property is fulfilled from instate inventories of the retailer.

(B) "Place of Business of the Retailer" means and includes:

A permanent location owned and or operated by the retailer where sales are customarily negotiated with customers. For example, a sales office, storefront, or outlet operated by the retailer where sales are negotiated or orders are taken would be a place of business of the retailer.

For the purposes of subdivisions (a) and (b), a place of business of the retailer would not include an administrative office, a location where the activities are limited to processing credit applications, or the homes or offices of agents or representatives of the retailer, including a location in which the retailer does not have a proprietary interest.

~~(2)~~ (3) EXCEPTIONS.

(A) State-administered local sales tax does not apply to certain sales of tangible personal property to operators of aircraft to be used or consumed principally outside the county in which the sale is made if such property is to be used or consumed directly and exclusively in the use of the aircraft as common carriers of persons or property under the authority of the laws

of the State of California, the United States, or any foreign government. On and after July 1, 1972, for county tax purposes this exemption is limited to 80 percent of the county tax.

(B) On or after July 1, 2008, when there is local participation in the sale or purchase of tangible personal property from outside this state, which is delivered to customers in California, state-administered Bradley-Burns local sales tax, not local use tax, will generally apply to the transaction whether or not the state sales tax is applicable.

The exception noted in subdivision (a)(3)(B) does not apply to leases.

(b) USE TAX. State-administered local use tax applies if the purchase is made from a retailer on or after the effective date of the local taxing ordinance and the property is purchased for use in a jurisdiction having a state-administered local tax and is actually used there, provided any one of the following conditions exist:

(1) ~~Title to the property purchased passes to the purchaser at a point outside this state~~There is no local participation, as defined in subdivision (a)(2), in the sale or purchase of the retailer's tangible personal property;

(2) The place of sale under Regulation 1802 is in this state but not in a jurisdiction having a state-administered local tax;

(3) The place of sale under Regulation 1802 is in a jurisdiction having a state-administered local tax and there is an exemption of the sale of the property from the sales tax but there is no exemption of the use of the property from the use tax;

(4) The property is purchased under a valid resale certificate.

State-administered local use tax does not apply to the storing, keeping, retaining, processing, fabricating or manufacturing of tangible personal property for subsequent use solely outside the state or for subsequent use solely in a county not imposing a local use tax.

(c) COLLECTION OF USE TAX BY RETAILERS. Retailers engaged in business in this state and making sales of tangible personal property, the storage, use or other consumption of which is subject to a state-administered local use tax, are required to collect the tax from the purchaser. It is immaterial that the retailer might not be engaged in business in the particular county or city in which the purchaser uses the property.

Retailers who are not engaged in business in this state may apply for a Certificate of Registration - Use Tax. Holders of such certificates are required to collect tax from purchasers, give receipts therefor, and pay tax to the board in the same manner as retailers engaged in business in this state.

As used in this regulation, the term "Certificate of Registration - Use Tax" shall include Certificate of Authority to Collect Use Tax issued prior to September 11, 1957.

(d) LEASES. If a lease is a continuing sale, or a continuing purchase, for the purposes of state tax, it shall be a continuing sale, or a continuing purchase, for the purposes of local tax. If a lease is neither a continuing sale nor a continuing purchase for the purposes of state tax, it shall be neither a continuing sale nor a continuing purchase for the purposes of local tax.

Regulation 1802. PLACE OF SALE AND USE FOR PURPOSES OF BRADLEY-BURNS UNIFORM LOCAL SALES AND USE TAXES.

Reference: Sections 6012.6, 6015, 6359, 6359.45, 7202, 7203.1, 7204.03 and 7205, Revenue and Taxation Code.

(a) IN GENERAL.

(1) RETAILERS HAVING ONE PLACE OF BUSINESS. For the purposes of the Bradley-Burns Uniform Local Sales and Use Tax Law, if a retailer has only one place of business in this state, all California retail sales of that retailer in which that place of business participates occur at that place of business unless the tangible personal property sold is delivered by the retailer or his or her agent to an out-of-state destination, or to a common carrier for delivery to an out-of-state destination.

(2) RETAILERS HAVING MORE THAN ONE PLACE OF BUSINESS.

(A) If a retailer has more than one place of business in this state but only one place of business participates in the sale, the sale occurs at that place of business.

(B) If a retailer has more than one place of business in this state which participate in the sale, the sale occurs at the place of business where the principal negotiations are carried on. If this place is the place where the order is taken, it is immaterial that the order must be forwarded elsewhere for acceptance, approval of credit, shipment, or billing. For the purposes of this regulation, an employee's activities will be attributed to the place of business out of which he or she works.

(3) PLACE OF PASSAGE OF TITLE IMMATERIAL. ~~If title to the tangible personal property sold passes to the purchaser in California, I~~it is immaterial that title passes to the purchaser at a place outside of the local taxing jurisdiction in which the retailer's place of business is located, or that the property sold is never within the local taxing jurisdiction in which the retailer's place of business is located.

Interested Party	Supports	Comments
CA Retailers Association	**Staff Recommendation**	Make no change to Regulation 1803. See pages 2-3.
CA State Association of Counties	**Staff Recommendation**	Make no change to Regulation 1803. See pages 4-5.
HdL Companies	**Staff Recommendation**	Make no change to Regulation 1803 at this time. See pages 6-7.
Douglas R. Boyd SR.	**Staff Recommendation**	Make no change to Regulation 1803 at this time. See pages 8-9
City of San Marcos	**Staff Recommendation**	Concurs with position taken by HdL – Make no change to Regulation 1803. See page 10.
City of Paso Robles	**Staff Recommendation**	Concurs with position taken by HdL – Make no change to Regulation 1803. See page 11.
City of Encinitas	**Staff Recommendation**	Make no change to Regulation 1803 at this time. See page 12.
City of Corning	**Staff Recommendation**	Make no change to Regulation 1803 at this time. See page 13.
City of Lake Forest	**Staff Recommendation**	Make no change to Regulation 1803 at this time. See page 14.
City of Mountain View	**Staff Recommendation**	Opposes a reinterpretation of Regulation 1803. See page 15
Orange County	**Staff Recommendation**	Make no change to Regulation 1803 at this time. See page 16.
MuniServices, LLC (MSLLC)	**MSLLC Proposal**	Amend Regulation 1803 on a retroactive basis. See **Exhibit 7**.
Robert E. Cendejas for the City of Ontario	**MSLLC Proposal**	Supports proposed change retroactively. See pages 17-18.
City of San Ramon	**MSLLC Proposal**	Supports proposed change retroactively. See page 19.
City of San Diego	**MSLLC Proposal**	Supports proposed change retroactively. See pages 20-21.
City of San Bernardino	**MSLLC Proposal**	Supports proposed change retroactively. See pages 22-23
City of Los Angeles	**MSLLC Proposal**	Supports proposed change retroactively. See page 24.
City of Long Beach	**MSLLC Proposal**	Supports proposed change retroactively. See page 25.
City of Sacramento	**MSLLC Proposal**	Supports proposed change retroactively. See page 26.
League of California Cities	**League/San Jose Proposal**	Amend Regulation 1803 on a prospective basis. See **Exhibit 8**.
City of San Jose	**League/San Jose Proposal**	Amend prospectively, but do not apply changes to lease transactions. See page 27.

CALIFORNIA RETAILERS ASSOCIATION
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April 5, 2007

Jeffrey L. McGuire, Chief
Tax Policy Division (MIC: 92)
State Board of Equalization
450 N Street
P.O. Box 942879
Sacramento, CA. 94279-0092

RE: Proposed Changes to Regulation 1803

Dear Mr. McGuire:

The California Retailers Association must continue to oppose the proposed changes to Regulation 1803, regarding the application of the local sales and use tax.

Under existing rules in California, if a product is shipped from an out-of-state location to an address in California, the retailer collects the tax at the rate in effect at the recipient's location and reports the tax based on the destination of each sale. This is true even if the sale is "negotiated" at an in-state location. This is consistent with the way virtually every other state in the country taxes this type of transaction.

Under the proposed change to Reg. 1803, retailers would be required to collect the tax at the rate in effect at the recipient's location, but report the tax as applicable to the site "where the sale was negotiated." This would be very problematic for several reasons.

First, it is not always clear where a particular sale is "negotiated." There are many variables that can come into play to make this determination. For example, if a chain store does not have a particular item in stock, the clerk at that store will search for the item in the company's inventory at other stores. Very often, the desired item is found in a store outside California. The clerk then relays the customer's credit card information and mailing address to a clerk at the store outside California. The out-of-state store then rings up the sale and ships the item directly to the customer in California. It would be virtually impossible for retailers to program their computers/POS systems in a way to properly capture this information to determine which local tax to apply. Even if retailers could find a way to build that ability into their systems, basing the tax allocation at the negotiation point would mean a massive programming effort just for California. Furthermore, forcing sales associates to manually make determinations and tax calculations on every "send" sale is simply a non-starter--it will lead to numerous instances where the incorrect rate of tax is collected.

Secondly, it would force multistate retailers to create one procedure when merchandise is shipped to California, and a different procedure when merchandise is shipped to any other state. The proposed changes to Regulation 1803 would add additional layers of complexity for retailers to collect and report tax properly in California. This is obviously expensive and burdensome to retailers, and will not produce any additional revenue for the state and local governments in California. It will only result in a redistribution of local sales tax revenues.

Maintaining a system whereby a retailer collects the local tax based on the "ship to" address of the merchandise and reporting that tax as applicable to the destination location is the best approach. It provides certainty (i.e., the address where the merchandise is sent is clear, whereas the location where the sale was "negotiated" is not necessarily known), and is much easier for retailers to collect and report the applicable tax properly (the tax can be calculated using an automated system and this practice is consistent with that of other states). For all the aforementioned reasons, the California Retailers Association opposes the proposed changes to Regulation 1803.

The California Retailers Association is a trade association representing major California department stores, mass merchandisers, supermarkets, chain drug and convenience stores, as well as specialty retailers such as auto, book and home improvement stores. Our members have more than 9,000 stores in California and account for more than $100 billion in sales annually.

Sincerely,

Heidi Barsuglia

Heidi Barsuglia
Director, Government Affairs

cc: Honorable Betty Yee, Chairwoman, First District (MIC 71)
Honorable Bill Leonard, Vice-Chair, Second District (MIC 78)
Honorable Michelle Steel, Member, Third District
Honorable Judy Chu, Ph.D., Member, Fourth District
Honorable John Chiang, State Controller, C/O Ms. Marcy Jo Mandel (MIC 73)
Mr. Geoffrey E. Lyle (MIC 50)
Ms. Leila Khabbaz (MIC 50)
Ms. Lynda Cardwell (MIC 50)

California State Association of Counties

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May 4, 2007

The Honorable Betty Yee, Chair
The Honorable Judy Chu, Vice Chair
The Honorable Michelle Steel, Member
The Honorable Bill Leonard, Member
The Honorable John Chiang, State Controller and Member
State Board of Equalization
450 N Street
P.O. Box 942879
Sacramento, CA 94279

Re: Reallocation and Recharacterization of Use Tax Revenues; Proposed Changes to Regulations 1802 and 1803

Dear Chair and Board Members:

On behalf of the California State Association of Counties (CSAC), I respectfully submit our opposition to the changes proposed to Regulation 1803, and the conforming change proposed to Regulation 1802. I also submit our neutrality on the other proposed change to Regulation 1802. There are many reasons that you should cast your vote against this proposal, which fall into the following three categories: arguments from statute, arguments from history, and arguments from policy.

First, and most importantly, is the argument from statute. California Revenue and Taxation Code Sections 7202 (b), relating to the local sales tax, and 7203 (a), relating to the local use tax, require in part that local agencies that opt into the "Bradley-Burns Uniform Local Sales and Use Tax" include in their implementing ordinance "provisions identical to those" that govern the state's sales and use tax laws. They also require a provision that "all amendments [to the state codes]...shall automatically become a part of the sales tax ordinance of the county." These code sections make it exceedingly clear that local agencies that have chosen to participate in the Bradley-Burns system – and all cities and counties have made that choice – agree that *the characterization of their local sales and use taxes will exactly mirror those of the state.* The proposal under consideration would subvert that requirement by having some transactions characterized as a state use tax but a local sales tax. This would not only be confusing for persons doing business in this state, but would directly contradict California law. The Board of Equalization's tax regulations exist to carry out and clarify statutes, and cannot contradict or undermine them. This proposed change brings before the Board primarily a legal question, so the Board must primarily look to the law for the answer. Therefore, on this basis alone, the Board must reject the proposed change.

Second is the argument from history. The staff documentation on this point – in which they show that the historical interpretation of law by the Board is consistent with current practice – is careful, extensive, and persuasive, so we will not dwell on it here at much length, except to rebut the presumption by the proponent that cities would not have chosen to join the Bradley-Burns system if it meant they could not collect sales tax (as opposed to use tax) on the transactions under consideration here. On the contrary, we would submit that the reason every city and county has chosen to have the Board of Equalization administer their local taxes under a uniform system is because the efficiencies are so great that even if they lost a minor amount of revenue by this difference in characterization of sales versus use tax, they gained far more revenue by not having to run their own system.

The several policy arguments are just as compelling. If the proponent's proposal were to become law, it would further invite a certain type of abuse whose use has accelerated rapidly over the past few years. Under these arrangements, a local jurisdiction agrees to refund to a retailer a certain percentage of the sales tax they generate – as high as 85% in some of the most recent cases – for artificially consolidating their state- or region-wide sales in one location within the city's limits. This belies the fact that the sales are in fact coming from many different jurisdictions. A small office of two or three individuals could funnel statewide sales to an out-of-state company in order to reap great financial rewards to the detriment of citizens in all of the jurisdictions where these products are actually being used. This is public money that is going directly to private hands with no resulting benefit to the general public. Sales and use taxes are critical to providing public services and facilities such as public safety and roadway maintenance to the residents of this state. Misusing them in this way not only diminishes these services and facilities, it increases the share of the tax burden borne by natural persons and less wealthy and influential companies, since the large companies that generate the most sales tax are the most lucrative and therefore most likely with which to make these sorts of arrangements.

The harm would be hugely exacerbated if the Board not only adopted this proposal, but also made it retroactive. Due to over two decades' worth of claims, the amount of money involved in a retroactive implementation of this proposal is staggering. It is important to keep in mind that this is not only public money against which many jurisdictions have bonded, but in the case of retroactive application this is money that jurisdictions have already spent: spent on roads, peace officers, parks, water supply, health services and hospitals, et cetera. So the Board would be creating liabilities for nearly every local agency in the state, since according to the Board's analysis this change would negatively impact almost every jurisdiction, while having a positive effect on only a few. So the public-at-large would suffer due to an obscure regulatory change that is supported neither by statute nor by history.

Our final policy argument is that this change would irretrievably reallocate sales and use taxes across county lines. Under the California Constitution as amended by Proposition 1A (2004), "the Legislature shall not enact a statute to...change the method of distributing revenues derived under...the Bradley-Burns Uniform Local Sales and Use Tax Law." (Constitution of California Article XIII, Section 25.5(a)(2)(A).) While the Board's actions can usually be overturned by later actions of the state Legislature, in this case that is not a possibility. So any reallocations made by adopting this proposal could not be changed by anything short of a constitutional amendment.

In summary, the proposed change is not supported by, and is in fact directly in conflict with, statute; the proposed change is not supported by, and is in fact directly in conflict with, the historical record; the proposed change would redirect public money into private hands in two different ways, especially if implemented retroactively, increasing the tax burden on natural persons and less wealthy and influential companies and sending many jurisdictions into financial difficulty; and the proposed change would irretrievably reallocate revenues across county lines, short of a highly unlikely constitutional amendment. For all of these reasons, we ask that you reject this proposal.

Sincerely,

/

Jean Kinney Hurst
Legislative Representative

cc: Jeffrey L. McGuire, Tax Policy Division (MIC 92)

THE HdL COMPANIES
Revenue Management for Local Government

Hinderliter, de Llamas & Associates
HdL Coren & Cone
HdL Software, LLC

April 6, 2007

Mr. Jeffrey L. McGuire, Chief
Sales and Use Tax Department – Tax Policy Division
State Board of Equalization
450 N Street, MIC 92
Sacramento, CA 94279-0092

Dear Mr. McGuire:

The following are our comments relating to the current proposals to retroactively revise regulations 1802 and 1803.

Generally speaking we support direct situs allocation of local sales & use tax, particularly wherever a legitimate claim can be made that the local agency receiving the funds is the one providing the public services to the business. We therefore agree that the proposed changes to Regulation 1802(d) (1) are logical and sound.

However, we have serious reservations about the proposed re-interpretation of Regulation 1803, particularly in the current environment where sales tax sharing agreements are becoming the determining factor in where a "place of sale" is located. Further lowering the bar as to what constitutes a "place of sale" or in-state "participation" will only fuel growth in this practice, and in the burgeoning industry set up to solicit government bidding on tax kickbacks in exchange for allocation of sales and use tax revenues.

These agreements are rebating 50% or more of public tax dollars to the private sector, and often corrupt (rather than encourage) the relationship between tax allocation and service burden. The possibility of direct allocation of local tax on shipments from out of state is worthy of future review but only in context with potential solutions to the problems that it would exacerbate.

We disagree for the reasons stated below, that <u>retroactive</u> application of the proposed changes to <u>either</u> regulation would be sound or beneficial.

- **The burden on local government.** No one knows the true dollar impact of allowing the proposed changes to apply retroactively to the 1350 pending claims. However, it *is* agreed that it would result in the largest tax shift in the history of the Bradley Burns Local Sales & Use Tax program and that the vast majority of the cities and counties in the State would have to pay back monies that have long been spent. Not even agencies with pending claims can be assured that they would be net "winners" after all redistributions were completed. It is this very type of situation that R & T section 7209 was designed to prevent.

- **The burden on taxpayers.** Retroactivity would require that taxpayers who are subjects of the claims research business activities and amend quarterly sales tax returns and schedules going back twelve years or more. This is an unnecessary and unfair request of companies who made a good faith effort to comply with the Board's regulations and reporting guidelines that were being administered at the time.

- **The burden on Board of Equalization staff.** Proponents of retroactivity have acknowledged that a high percentage of the pending cases will ultimately go unresolved because some companies will have closed down, moved, been acquired, accounting records will have been destroyed, key tax department personnel will have long since retired or otherwise moved on, etc… This is a considerable waste of Board resources and staff time to ask that thorough investigations be done on a large inventory of cases, when it's acknowledged at the outset that a large number of these cases will ultimately be dead ends.

  The retroactive claims that are finally tracked down will be subject to appeal by the losing jurisdictions which will take additional resources and time all of which adds to the administrative fees charged all local governments while detracting from the Board's primary goal of revenue collection.

When trying to decide the true intent of the Board Members (past or present), we should all agree upon a standard. This standard should be the Board's own written regulations which are usually adopted with input from taxpayers, local jurisdictions and their consultants. Revisions and clarifications are an important part of the process and the Board's willingness to continually re-evaluate and explore possible improvements are greatly appreciated.

However, revisions and clarifications should be requested *and pursued* in a timely fashion (not a decade after the fact), and should be applied prospectively. To do otherwise is simply unfair to all of the participants in this process (local governments, taxpayers, and Board staff) who have made a good faith effort to comply with the Board's regulations *as written*, and have refrained from submitting or pursuing inquiries based on speculation as to their true meaning or intent.

Sincerely,

Lloyd de Llamas

LdL:moh

cc: Ms. Lynn Whitaker
Ms. Lynda Cardwell
Mr. Bob Wils
Mr. Larry Micheli
Mr. Doug Boyd

Douglas R. Boyd, Sr.
Attorney At Law
7665 N Ben Lomond Ave.
Glendora, CA 91741
Cell (626) 826-8882
Fax (626) 963-5995
SrDoug@aol.com

April 6, 2007

Mr. Jeffrey L. McGuire, Chief
Sales and Use Tax Department – Tax Policy Division
State Board of Equalization
450 N. Street, MIC 92
Sacramento, Ca 94279-0092

Dear Mr. McGuire:

While opinions may differ on the merits of proposed changes to Regulation 1802 and 1803, the unfairness of applying these changes retroactively is manifest.

I was the proponent of two changes to Regulation 1802 in the late 1980's and early 1990's. One of them, the so-called warehouse rule, simply involved the Board applying the plain language of the existing regulation. The Board wisely established a prospective October 1993 effective date even in this situation, where there was neither question of divining anyone's intent nor any ambiguity in the wording.

My other matter also received a prospective effective date by the Board, as do almost all regulatory changes and almost all statutory changes. Changing the rules after the game is played is inherently unfair, fraught with unintended consequences and guaranteed to produce inaccurate results.

In these matters, it would be a major burden on government entities and taxpayers to reconstruct records going back to the early 1990's. That is one reason why the California Retailers Association and California State Association of Counties oppose retroactivity.

Board staff also strongly opposes retroactivity, and for good practical reasons. It would be their job to work with thousands of taxpayers and local jurisdictions to reconstruct records of transactions long forgotten. Many records from ten to fifteen years ago no longer exist. Many taxpayers have gone out of business, passed away, or are otherwise unable to provide information needed to do a competent job of reallocation.

Staff developed in 1996, at the direction of the Board, a "winners and losers" list for the "mass appeal" matter of MBIA. It is Exhibit Seven in the Second Discussion Paper on Regulation 1803. Please note that there are 49 "winners" and 476 "losers." Staff advises that a conservative estimate as of today is between twice and triple the amounts subject to reallocation in this Exhibit.

Given the tremendous difficulty to all parties involved, the conceded inaccuracy of the amounts subject to reallocation, and the fact that reallocation is a "zero sum game", what is the public policy urgency in applying these changes retroactively?

Where's the fire?

Page 13 of the aforementioned Exhibit Seven shows the financial impact in 1996 of the MRC (now MBIA/MSLLC) claims. Item Four notes that the unaudited total of these claims in 1996 was $38,394,067. If one is conservative by assuming this number is now just doubled and not tripled, it would amount to $76,788,134 today. If one further assumes that a consultant would be entitled to 25% of funds reallocated, and that all these MRC/MSLLC claims are verifiable, 25% would amount to $19,197,033.

Twenty years ago, I was concluding three years of service as Chief Deputy to the Hon. Ernest J. Dronenburg, Jr. I have had the pleasure of working with the Board ever since as a consultant. My experience has been that a prospective effective date for regulatory changes is a major benefit to the Board and to taxpayers.

The rules of any game should not be changed after the game has been played. In sports, changes apply to future games and seasons. In taxation, where people's livelihoods and families are at stake, a playing field without a trap door is even more important.

Sincerely,

Douglas R. Boyd, Sr.

cc: Hon. John Chaing
Hon. Judy Chu
Hon. Bill Leonard
Hon. Michelle Steel
Hon. Betty Yee
Mr. Lloyd de Llamas
Mr. Larry Micheli

1 Civic Center Drive
San Marcos, CA 92069-2918

Telephone
760.744.1050
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April 12, 2007

Mr. Jeffrey McGuire, Chief
Tax Policy division (MIC: 92)
Board of Equalization 450 N. Street
P.O. Box 924879
Sacramento, CA 94279-0092

Re: Redistribution of Local Use Tax

Dear Mr. McGuire:

It is the City of San Marcos understanding that the Board of Equalization is currently evaluating a proposal to retroactively re-interpret its regulations on distribution of local taxes that involve shipment of merchandise from outside of California. If adopted, the change would potentially redistribute hundreds of millions of dollars and result in the concentration of "use tax" to a few cities and counties and create a hardship for the majority of cities and counties within the State.

Attached is a letter from the HdL Companies (HdL) dated April 6, 2007, relating to the current proposals to retroactively revise regulations 1802 and 1803. The City strongly agrees with HdL that the retroactive application of the proposed changes to either regulation would not be sound or beneficial for the reasons delineated in their letter.

The Board of Equalization's Business Taxes Committee is scheduled to review this issue on May 31, 2007. Please provide this letter to the Committee for their consideration.

Sincerely,

Liliane G. Serio, CPA
Finance Director

cc: Paul Malone, City Manager
Lloyd de Llamas, HdL Companies

City of Paso Robles:

From: Mike Compton [mailto:MCompton@prcity.com]
Sent: Thursday, April 12, 2007 8:56 AM
To: McGuire, Jeff
Subject: Regulation 1803

Dear McQuire,

The City of Paso Robles concurs with the position recently communicated to the Board by HdL Companies via their letter dated April 6, 2007 (copy attached). It clearly identifies the concerns and issues facing a majority of California cities and counties. The proposed changes, if considered outside of the full context of the entire sales tax remittance, collection and distribution system, would seem contrary to good public policy.

The City of Paso Robles would urge the board to consider the proposed changes in the framework as suggested by HdL Companies.

Respectfully,

Mike Compton

Director of Administrative Services/Treasurer
mcompton@prcity.com
City of Paso Robles
1000 Spring Street
Paso Robles, CA 93446
805-237-3999
805-237-6565 FAX

City of Encinitas

April 2, 2007

Mr. Jeffrey McGuire, Chief
Tax Policy Division (MIC:92)
Board of Equalization 450 N. Street
P.O. Box 92479-0092

RE: Regulation 1803 – Redistribution of Local Use Tax

Dear Mr. McGuire:

I have become aware that the Board of Equalization's Business Taxes Committee is scheduled to review the issue of possible revisions to Regulation 1803 that would potentially redistribute hundreds of millions of dollars of Local Use Tax. The implications of these revisions are significant and will have an enormous impact to local agencies revenues. However, in the absence of an analysis, the impact to individual agencies is unknown. I urge you not to take action on the proposal either retroactively or proactively unless an analysis of the impact is performed first.

Sincerely,

James Bond
Mayor
City of Encinitas

City of Corning

794 Third St. Corning, CA 96021 (530) 824-7020 Fax (530) 824-2489

March 29, 2007

Mr. Jeffrey McGuire, Chief
Tax Policy Division (MIC:92)
Board of Equalization 450 N. Street
PO Box 924879
Sacramento, CA 94279-0092

Re: Opposition to Proposed Revision to Regulation 1802 and Regulation 1803

Dear Mr. McGuire;

The City of Corning opposes any change to the Board of Equalization Regulations, which would redistribute retroactively any Sales Tax or Use Tax.

Such a change would further destabilize local government revenues and finances.

As I am sure, you are aware, Cities and Counties have made commitments to provide service to our citizens, and these commitments are based upon our revenue flow. Furthermore, cities have made long-range commitments based upon both the realities of land use within our communities and potential Sales Tax generation. Clearly, two-thirds of Corning's discretionary General Fund income is Sales Tax.

Imagine the kind of instability that could be created by making changes in Sales Tax and Use Tax regulations.

Please, make no changes.

RECEIVED
APR 04 2007
TAX POLICY DIVISION

Sincerely,

Stephen J. Kimbrough
City Manager

Cc: City Council

SJK: rsd

CITY OF LAKE FOREST

April 4, 2007

Jeffrey McGuire, Chief
Tax Policy Division (MIC: 92)
Board of Equalization 450 N. Street
P.O. Box 924879
Sacramento, CA 94279-0092

Dear Mr. McGuire:

It is our understanding that the Board of Equalization (BOE) is currently evaluating a proposal to retroactively re-interpret its regulations on distribution of local taxes that involve shipment of merchandise from outside of California.

On behalf of the City of Lake Forest, I would like to express our opposition to the *retroactive* implementation of the proposal to change certain out-of-state sales from use taxes to local sales taxes. This change would require that sales processed in California, but shipped from out-of-state, be converted from use tax to local sales tax transactions.

The City of Lake Forest currently receives approximately ten percent, or $1.5 million, of total taxes from the use tax pool allocation. Regardless of our philosophical views on this issue, retroactive implementation would materially affect our previously budgeted and disbursed sales and use taxes. In addition, administrative fees charged to the City by the BOE could increase dramatically as a result of the significant effort that would be required to make the proposed change retroactively. Further, businesses within the city could be impacted negatively due to retroactive implementation.

For these reasons, we believe the BOE should take no action on the proposal until a more detailed analysis of the potential impacts has been completed. Should you have any questions regarding our concerns, please contact Liz Andrew, Director of Finance, at (949) 461-3540.

Sincerely,

CITY OF LAKE FOREST

Robert C. Dunek
City Manager

c: Liz Andrew, Director of Finance/City Treasurer

From: Locke, Robert
Sent: Friday, April 06, 2007 2:24 PM
To: 'jeff.mcguire@boe.ca.gov'
Cc: Locke, Robert
Subject: Regulation 1803

Dear Mr. McGuire,
I am writing in opposition to the BOE's reinterpretation of Regulation 1803 and especially its retroactive application. Retroactive reallocations are inherently bad public policy as sales tax allocations are received and spent based on good faith reliance in the accuracy of distributions by the BOE. The pain incurred by the agency giving back taxes is disproportionate to the agency receiving a one-time windfall. This pain is aggravated by the retroactive application of an admittedly new interpretation of a long standing regulation. If the reinterpretation has merit, do not apply it to past allocations but on a go forward basis. I have no way of estimating the damage or financial loss to my City, conceivably the City could gain. However, even if my agency should gain, it is still bad public policy at its worst to put a majority of sales tax receiving public agencies in California through the pain of returning sales tax revenues that have already been spent for the windfall gain of a small, undeserved group of public agencies, and their consultants, because of a reinterpretation of regulation. On what basis can a new interpretation be considered appropriate and fair if it is to apply retroactively. This will cause outrage and loud criticisms of the BOE and bring disgrace on an important State agency. No public agency enjoys watching the mistakes of others and the negative publicity mistakes bring to all levels of government. Please consider the ramifications and reasonableness of your actions. Act in the public interest, don't react to the pressure of special interests.

Thank you.

Sincerely,

Robert F. Locke
Finance & Admininstrative Services Director
City of Mountain View
(650) 903-6005

CHRIS NORBY
Orange County Board of Supervisors
Supervisor, Fourth District

Orange County Hall of Administration
333 W. Santa Ana Blvd., P.O. Box 687
Santa Ana, California 92702-0687
Phone (714) 834-3440 Fax (714) 834-2045
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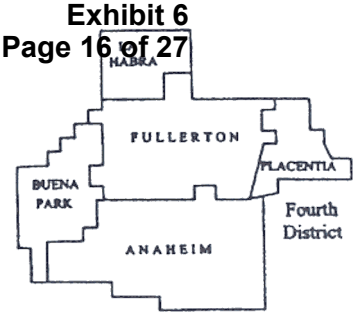

April 3, 2007

The Honorable Michelle Steel
Member, Board of Equalization – 3
P.O. Box 942879
Sacramento, CA 94279

RE: OPPOSE – Re-Interpretation of Regulations on Distribution of Local Taxes

Dear Board Member Steel:

The Board of Equalization is currently evaluating a proposal to retroactively re-interpret their regulations on distribution of local taxes that involve shipment of merchandise from outside of California. If adopted, the change would potentially redistribute hundreds of millions of dollars and create the potential for concentrating "use tax" into the hands of a lucky few "winners" while creating headaches for losing jurisdictions that have already spent the money.

As the lowest urban property tax county in California, the County of Orange is particularly susceptible financially to changes in the allocation of sales and use taxes. The notion of a retroactive reallocation of sales and use taxes is even more disturbing. We are challenged on an annual basis to identify and secure revenues to provide vital County services to more than three million residents and scores of businesses. A thorough financial analysis of the potential impact of any rule change should be thoroughly explored and examined in a public setting before moving forward on any changes to the regulations. It seems like a revision or re-interpretation of the regulations as contemplated to create a situation where jurisdictions might be inclined to offer sales or use tax rebates to business in order to attract more point of sale credit—as the City of Oakland did with United Airlines over jet fuel sales.

The County of Orange urges you to study this proposal and thoroughly analyze its impacts before continuing to consider it. We would like our opposition to the proposal to be placed on the record.

Sincerely,

CHRIS NORBY
Chairman of the Board
Supervisor, Fourth District

cc: ✓Jeffrey McGuire, Chief, Tax Policy Division, Board of Equalization
Members, Orange County Board of Supervisors
Thomas G. Mauk, County Executive Officer

Robert E. Cendejas
Attorney at Law
1725 North Juliet Court
Brea, CA 92821

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VIA FACSIMILE: (916) 322-4530
VIA E-MAIL: Lynda.cardwell@boe.ca.gov

February 20, 2007

Mr. Jeffrey L. McGuire, Chief
Tax Policy Division (MIC: 92)
Board of Equalization
450 N Street
P.O. Box 942879
Sacramento, CA 94279-0092

RE: BTC- Reg. 1803
Support Clarification

Dear Mr. McGuire:

On behalf of the City of Ontario, I am submitting this letter in support of clarifying amendments to Regulation 1803 that sales negotiated in California and fulfilled by shipment from out of state are subject to the local sales tax. These amendments would clarify the original and intended meaning of the Bradley-Burns sales tax law, and as such, should have retroactive effect

My review of the enabling city ordinances, local sales and use tax statutes and regulations from their inception to the present, case law and other historical writings, make it clear that there is no requirement that the property be physically located either in the taxing jurisdiction or in California when the sales process is completed, in order for the local sales tax to apply.

Further, application of these sales as local sales tax transactions would simplify and ease both the taxpayer's and the Board's compliance and administrative burdens. It is much easier for the taxpayer to allocate its local tax to the location(s) of its California sales office(s). This also matches the tax revenue with the business location utilizing valuable city resources such as police and fire protection.

Allocation of these sales as use tax transactions places an undue burden on taxpayers. In order to properly allocate the tax as a use tax, the taxpayer must first determine if the property will be delivered from a California warehouse or from an out-of-state

warehouse. If it is a California warehouse, then there is no controversy; the tax is allocated to the California sales office.

However, if the property is delivered from the out-of-state warehouse the taxpayer must track the sales to their destination. This is not normally the way the taxpayer's accounting records are set up. Having done that, the taxpayer must then determine in which county each of the sales belongs, in order to allocate the tax to the 58 countywide pools. This is that much more burdensome for a company headquartered out of state This all becomes even more complex when a sales order is for goods that will be partly delivered from a California warehouse and partly delivered from an out of state warehouse.

Further, having to determine whether if it is the local sales tax or whether it is the local use tax that applies to sales orders received at the California sales office, is burdensome and serves no worthwhile purpose. The Board, cities and businesses have for many years supported situs allocation of the local tax. In this case, the local tax statutes, regulations and court decisions present a clear basis for determining the applicable tax to be a sales tax, which is allocated to the California place of business. This is both the practical and fair way to allocate the tax.

Respectfully submitted,

Robert E. Cendejas

Robert E. Cendejas

cc: Grant Yee, Ontario

CITY OF SAN RAMON

2222 CAMINO RAMON
SAN RAMON, CALIFORNIA 94583
PHONE: (925) 973-2500
WEB SITE: www.sanramon.ca.gov

March 15, 2007

The Honorable Betty T. Yee, Chair
The Honorable Judy Chu, Vice Chair
The Honorable Bill Leonard, Member
Honorable Michelle Steel, Member
The Honorable John Chiang, State Controller and Member
450 N Street
P.O. Box 942879
Sacramento, CA 94279

Dear Chair and Board Members:

The City of San Ramon supports the proposed clarifying amendments to Regulations 1802 and 1803. Sales negotiated in state and fulfilled by shipment from out-of-state are subject to situs allocation as Bradley-Burns sales taxes whether or not they are fulfilled by shipment from out of state.

Our City has traditionally supported allocation of local sales or use tax by situs whenever reasonably possible because that policy better matches local revenues with a jurisdiction's related service and infrastructure costs. It also provides much greater revenue accountability, thus increasing budgetary control and understanding. Moreover, requiring taxpayers to allocate to only a few rather than 58 jurisdictions in reporting their local taxes will reduce taxpayer record-keeping and compliance burdens. We understand that it normally takes both Board Staff and local jurisdiction consultants months, if not years, of investigation to determine the place where title passes under the present facts-and-circumstances test now imposed under Board Staff policy.

This City respectfully requests favorable consideration by Staff of the proposed clarifying amendments to Regulations 1803 and 1802 that reflect the original and continuing language of RTC Sections 7202 and 7205 and the original 1956 Regulations implementing the Bradley-Burns Act immediately after its enactment.

The City of San Ramon thanks Board Staff for considering these requests.

Sincerely,

Greg Rogers
Finance Director/Treasurer

cc: Jeffrey L. McGuire, Tax Policy Division

Via Electronic Mail

March 15, 2007

Honorable Michelle Steel, Member
450 N Street
P.O. Box 942879
Sacramento, CA 94279

Dear Board Member Steel:

The City of San Diego supports the proposed clarifying amendments to Regulations 1802 and 1803. Sales negotiated in state and fulfilled by shipment from out-of-state are subject to situs allocation as Bradley-Burns sales taxes whether or not they are fulfilled by shipment from out of state.

Our City has traditionally supported allocation of local sales or use tax by situs whenever reasonably possible because that policy better matches local revenues with a jurisdiction's related service and infrastructure costs. It also provides much greater revenue accountability, thus increasing budgetary control and understanding. Moreover, requiring taxpayers to allocate to only a few rather than 58 jurisdictions in reporting their local taxes will reduce taxpayer record-keeping and compliance burdens. We understand that it normally takes both Board Staff and local jurisdiction consultants months, if not years, of investigation to determine the place where title passes under the present facts-and-circumstances test now imposed under Board Staff policy.

This City respectfully requests favorable consideration by Staff of the proposed clarifying amendments to Regulations 1803 and 1802 that reflect the original and continuing language of RTC Sections 7202 and 7205 and the original 1956 Regulations implementing the Bradley-Burns Act immediately after its enactment.

The City of San Diego thanks Board Staff for considering these requests.

Sincerely,

Mary Lewis

Mary Lewis
Financial Management Director

cc: Jeffrey L. McGuire, Tax Policy Division

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Ms. Randie L. Henry, randie.henry@boe.ca.gov
Ms. Sharon Jarvis, sharon.jarvis@boe.ca.gov
Ms. Trecia Nienow, trecia.nienow@boe.ca.gov

300 North "D" Street • San Bernardino • CA 92418-0001
www.ci.san-bernardino.ca.us

April 3, 2007

The Honorable Betty T. Yee, Chair
The Honorable Judy Chu, Vice Chair
The Honorable Bill Leonard, Member
Honorable Michelle Steel, Member
The Honorable John Chiang, State Controller and Member
450 N Street
P.O. Box 942879
Sacramento, CA 94279

Dear Chair and Board Members:

The City of San Bernardino supports the proposed clarifying amendments to Regulations 1802 and 1803. Sales negotiated in state and fulfilled by shipment from out-of-state are subject to situs allocation as Bradley-Burns sales taxes whether or not they are fulfilled by shipment from out of state.

Our City has traditionally supported allocation of local sales or use tax by situs whenever reasonably possible because that policy better matches local revenues with a jurisdiction's related service and infrastructure costs. It also provides much greater revenue accountability, thus increasing budgetary control and understanding. Moreover, requiring taxpayers to allocate to only a few rather than 58 jurisdictions in reporting their local taxes will reduce taxpayer record-keeping and compliance burdens. We understand that it normally takes both Board Staff and local jurisdiction consultants months, if not years, of investigation to determine the place where title passes under the present facts-and-circumstances test now imposed under Board Staff policy.

This City respectfully requests favorable consideration by Staff of the proposed clarifying amendments to Regulations 1803 and 1802 that reflect the original and continuing language of RTC Sections 7202 and 7205 and the original 1956 Regulations implementing the Bradley-Burns Act immediately after its enactment.

The City of San Bernardino thanks Board Staff for considering these requests.

Sincerely,

Barbara Pachon
Director of Finance

cc: Jeffrey L. McGuire, Tax Policy Division

INTERGOVERNMENTAL RELATIONS

MAR 07 2007

RESOLUTION

WHEREAS, any official position of the City of Los Angeles with respect to legislation, rules, regulations or policies proposed to or pending before a local state or federal governmental body must have been first adopted in the form of a Resolution by the City Council with the concurrence of the Mayor; and

WHEREAS, Bradley-Burns sales tax revenues arising from sales activities consummated in the City of Los Angeles are to be distributed 100 percent to this City, but Bradley-Burns use tax revenues are usually distributed through the county pools where the City of Los Angeles receives only approximately 32 percent from the Los Angeles County pool; and

WHEREAS, the Staff of the State Board of Equalization treats sales ordered through a registered place of business located in this City but fulfilled from shipment from out of state as subject to the local use rather than the local sales tax, thus requiring distribution through county pools and reducing revenues received by this City; and

WHEREAS, the City of Los Angeles has contracted with MuniServices LLC ("MSLLC") to handle all issues relating to sales and uses taxes involving this City; and MSLLC has submitted correspondence and made appearances seeking clarifications in the Board's current Bradley-Burns regulations, particularly Regulations 1802 (a) (3) and 1803 (a) (1); and

WHEREAS, the Members of the State Board of Equalization ("Board") have initiated formal proceedings to consider clarifying its sales and use tax regulations to cause revenue from sales ordered through a registered place of business to be reported to the jurisdiction it is located in; and

WHEREAS, the City of Los Angeles currently has pending one-hundred-eighteen appeals involving such sales, and the rough estimate of the potential gross recovery on such claims is approximately 9.2 million dollars, thus making the principles involved in this case important to the City;

NOW THEREFORE, BE IT RESOLVED, with the concurrence of the Mayor, that by the adoption of this Resolution, the City of Los Angeles hereby includes in its 2007-08 State Legislative Program SUPPORT of the efforts of MSLLC on its behalf to seek such clarifications in the Board Bradley-Burns Regulations as may be necessary to lead to distribution of the funds in question to this City.

Presented By: _____
BERNARD PARKS
Councilmember, 8th District

MAR 07 2007

Seconded By: _____

EG

07-0002-S48

CITY OF LONG BEACH

DEPARTMENT OF FINANCIAL MANAGEMENT

333 West Ocean Boulevard 6th Floor • Long Beach, CA 90802

Via Electronic Mail

April 19, 2007

Honorable Betty T. Yee, Chair
Honorable Judy Chu, Vice Chair
Honorable Bill Leonard, Member
Honorable Michelle Steel, Member
Honorable John Chiang, State Controller and Member

450 N Street
P.O. Box 942879
Sacramento, CA 94279

Dear Chair and Board Members:

The City of Long Beach supports the proposed clarifying amendments to Regulations 1802 and 1803 regarding sales negotiated in state and fulfilled by shipment from out-of-state. Such sales should be subject to situs allocation as Bradley-Burns sales taxes whether or not they are fulfilled by shipment from out of state.

Our City has traditionally supported situs-based allocation of local sales or use tax whenever reasonably possible because it best aligns local revenues with a jurisdiction's related service and infrastructure costs. It also provides much greater revenue accountability, thus increasing budgetary control and understanding. Moreover, requiring taxpayers to allocate to only a few rather than 58 jurisdictions in reporting their local taxes reduces record-keeping and compliance burdens.

The City of long Beach respectfully requests favorable consideration of the proposed clarifying amendments to Regulations 1803 and 1802 that reflect the original and continuing language of RTC Sections 7202 and 7205, and the original 1956 Regulations implementing the Bradley-Burns Act immediately after its enactment.

The City of Long Beach thanks the Board and its Staff for considering this recommendation.

Sincerely,

Michael Killebrew
Director of Financial Management/CFO
City of Long Beach, California

cc: Jeffrey L. McGuire, Tax Policy Division

DEPARTMENT OF
FINANCE

ADMINISTRATION DIVISION
RUSSELL T. FEHR
DIRECTOR OF FINANCE

CITY OF SACRAMENTO
CALIFORNIA

SACRAMENTO CITY HALL
915 I STREET
5TH FLOOR
SACRAMENTO, CA
95814-2604

PH: 916-808-5845
FAX: 916-808-5755

April 16, 2007

The Honorable Betty T. Yee, Chair
The Honorable Judy Chu, Vice Chair
The Honorable Bill Leonard, Member
Honorable Michelle Steel, Member
The Honorable John Chiang, State Controller and Member
450 N Street
P.O. Box 942879
Sacramento, CA 94279

Dear Chair and Board Members:

The City of Sacramento supports the proposed clarifying amendments to Regulations 1802 and 1803. Sales negotiated in state and fulfilled by shipment from out-of-state are subject to situs allocation as Bradley-Burns sales taxes whether or not they are fulfilled by shipment from out of state.

Our City has traditionally supported allocation of local sales or use tax by situs whenever reasonably possible because that policy better matches local revenues with a jurisdiction's related service and infrastructure costs. It also provides much greater revenue accountability, thus increasing budgetary control and understanding. Moreover, requiring taxpayers to allocate to only a few rather than 58 jurisdictions in reporting their local taxes will reduce taxpayer record-keeping and compliance burdens. We understand that it normally takes both Board Staff and local jurisdiction consultant's months, if not years, of investigation to determine the place where title passes under the present facts-and-circumstances test now imposed under Board Staff policy.

This City respectfully requests favorable consideration by Staff of the proposed clarifying amendments to Regulations 1803 and 1802 that reflect the original and continuing language of RTC Sections 7202 and 7205 and the original 1956 Regulations implementing the Bradley-Burns Act immediately after its enactment.

The City of Sacramento thanks Board Staff for considering these requests.

Sincerely,

Russell T. Fehr
Director of Finance

RECEIVED
APR 24 2007
TAX POLICY DIVISION

cc: Jeffrey L. McGuire, Tax Policy Division
Melanie Darling, State Controller's Office

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

April 5, 2007

Mr. Geoffrey E. Lyle
Section Supervisor,
Business Taxes Committee Section
State Board of Equalization
450 N St., MIC: 50
Sacramento, CA 95814

Re: Interested Party Proceeding – Regulation 1803. (Sales negotiated in State and fulfilled by shipment from out of state.)

Dear Mr. Lyle:

This letter is in response to the State Board of Equalizations Staff's Initial Discussion Paper issued January 22, 2007. During the second interested parties' meeting which was held on March 22, 2007, I had pointed out my concerns regarding potential changes to Regulation 1803 and asked to get a clarification if there was any intent to include leased transactions. It was not clear to me if this was taken into consideration during the meeting. Therefore, in order to eliminate any potential loopholes or confusion in Regulation 1803, the City of San Jose would like to respectfully request that the language clearly define that any change to the Regulation does not apply to leased transactions.

Should you need further clarification, please feel free to contact me at (408) 535-7091.

Sincerely,

David McPherson
Deputy Director, Finance Department

DM:bc

MuniServices, LLC.
1037 Suncast Lane, Suite 110
El Dorado Hills, California 95762
Phone: 800.800.8181 Fax: 916.939.7752
www.MuniServices.com

April 6, 2007

Mr. Geoffrey E. Lyle
Section Supervisor,
Business Taxes Committee Section
State Board of Equalization
450 N St., MIC: 50
Sacramento, CA 95814

Re: Interested Party Proceeding – Regulations 1803 and 1802. (Sales negotiated in State and fulfilled by shipment from out of state.)

Dear Mr. Lyle:

This letter responds to the Board Staff's March 13, 2007 Second Discussion Paper on the above subject, and the March 22 Interested Party Meeting held in Sacramento that followed. The primary substantive issue concerns whether the legal incidence of the Bradley-Burns sales tax is on the conduct of sales activities in the taxing jurisdiction within the meaning of RTC Sections 7202 and 7205 (and most of the BOE Regulations interpreting those provisions), without regard to where the "sale" might have been completed for commercial and state sales tax law purposes.

A major procedural issue concerns whether the Board Staff's Discussion Papers are correct in implying that clarifying the current regulations retroactively as requested would also necessarily require full retroactive correction of all the other outstanding claims involving whether Bradley-Burns sales tax applies to the transactions now at issue before the Board Members in Cities of Los Angeles and San Jose , Case ID 04-009. None of the other similar cases have yet been presented to the Board Members, and therefore, consideration of their disposition under Section 7209 of the Revenue and Taxation Code in this Interested Party proceeding would appear to be both premature and unnecessary. Neither Discussion Paper addressed this concern.

Introduction

MuniServices LLC ("MSLLC") contends that the initial Board Regulations implementing the Bradley-Burns statute in 1956 conclusively sourced local revenues from "exercise of the privilege of selling personal property" to the "place of business" where the exercise occurred, without regard to where title or ownership passed. These regulations were altered **retroactively** by the Board in 1970 and 1971 without statutory authority in an unlawful attempt to cause the sales at issue to be subject to the Bradley-Burns use tax rather than the sales tax. These drastic changes caused revenues to be distributed through county pools, rather than directly to the jurisdiction where the place of business that originated the sales was located. Thus, local revenues that had been distributed to many jurisdictions directly were shifted to formula distribution through county pools overnight.

In 1956, and today, California's state sales tax and its commercial law (since 1965 the Uniform Commercial Code ("CUCC"), but previously the Uniform Sales Act ("USA"), former Civil Code Sections 1721, et seq., determined the time and place of sale with regard to where and when the "property" ("ownership" or "title") in the tangible personal property sold transferred to the purchaser seller. The state sales tax under RTC Section 6051 conditions application of that tax on completion of a transaction "in this state."

Thus, the commercial law test of where ownership passes has always applied in determining whether the state sales tax applies. But the "in this state" test does not appear in RTC sections 7202 and 7205, the Bradley-Burns sales tax statute, either directly or by cross-reference, and therefore the commercial law test is irrelevant to how the local sales tax applies. Nevertheless, Board Staff has administered the local tax as if it did since at least 1986, and probably as early as 1971. (In 1986, this problem was first brought to the attention of the Board by a reallocation request which is still outstanding and undecided.)

The Appealing Cities in Cities of Los Angeles and San Jose, claim that the Bradley-Burns statute does not incorporate a geographic "place of sale" test based on commercial law, because it has always contained a "conclusive presumption" that Bradley-Burns sales tax revenues are to be sourced to the place of business where the sales orders are taken or negotiated. (See 1956 version of present 18 Cal. Code Regs. Section 1802[1] attached as Exhibit A-1, originally numbered as Regulation 2202.)

The Appealing Cities also contend that the Bradley-Burns statute was intentionally drafted in this manner, because the cities, whose authority to adopt city business license or sales taxes preceded enactment of the Bradley-Burns statute, were concerned that there be no "leakage" of revenue under the new statute similar to that suffered under the existing ordinances which, in most cases, exempted sales delivered outside the taxing jurisdiction. That exemption provided a level local tax environment and protected taxed city retailers from untaxed suburban competition. (See 1956 bulletins describing Bradley-Burns issued by the League of California Cities ("League") and the County Supervisors Association of California ("CSAC") attached as Exhibits B-1 and B-2.)

The Petitioners also contend that Regulation 2203, as first adopted in 1956, was administered to recognize the "conclusive presumption" adopted in Regulation 2202 that Bradley-Burns revenues were to be sourced to the retailer's California "place of business" where sales were negotiated or orders taken. When adopted and until revised in 1970, Regulation 2203 contained a cross-reference to Regulation 2015 (Ruling 55), the predecessor of present Regulation 1620. (See 1956 version of present Regulation 1803 attached as Exhibit A-2 and originally numbered Regulation 2203.) Regulation 2015 included precise language that sales tax applied to the type of transaction at issue in this proceeding. (See 1956 version of present Regulation 1620 attached as Exhibit A-3 and originally numbered Regulation 2015, subdivision A. 2. (a) (1).)

[1] All regulation references is this letter are to 18 Cal. Code Regs.

At that time, most sales of this type that were delivered from out of state to a California purchaser were subject to the state sales tax. The case law, as exemplified by Diebold v. State Board of Equalization (1959) 168 Cal App. 2d 628, used a facts-and-circumstances test to determine where ownership transferred under the USA and placed the burden of proof squarely on the taxpayer to prove that the sales tax did not apply, when the negotiations occurred at a fixed place of business in California. (See 1961 version of present Regulation 1628, attached as Exhibit A-4 and originally numbered Regulation 2028.) In 1965, that regulation was strengthened to require such proof to be "clear and convincing." (See 1965 version of present Regulation 1628 attached as Exhibit A-5 and numbered Regulation 2028.)

Because this heavy burden of proof could not often be met conveniently by taxpayers they usually paid the state as well as the Bradley-Burns sales tax during the period 1956-1971on this type of transaction. Only in late 1971 was Regulation 2028 renumbered as Regulation 1628 and the present provisions included in it, particularly subdivision 1628 (b) (3) (D) which shifted the "default" rule for determining which tax applies for state purposes to "use" tax. (See 1971 version of Regulation 1628 attached as Exhibit A-6.) In 1970, the previous cross-reference to Regulation 2015 (Ruling 55) in Regulation 2203 was also dropped when both regulations were revised and renumbered as Regulations 1620 and 1803, respectively. (See Exhibits A-7 and A-8.) The latter change removed any reference that sales tax applied to this type of transaction from the Bradley-Burns Regulations. At the same time, the requirement was added to renumbered Regulation 1802 (from Regulation 2202) (a) (3) that local sales tax applied to this type of sale only if title passed in California (See Exhibit A-8), a direct repudiation of the 1956 agreement reflected in Exhibit A-1.

The cumulative effect of revising and renumbering the original governing regulations in the period 1970-71 was to attempt to "flip" them to be subject to use taxes rather than sales taxes for both Bradley-Burns and state purposes. This effort fails without question for Bradley-Burns purposes, because there is no statutory authority for it.[2]

Board Staff has claimed that the Appealing Cities have no corroboration for this account of the early history of the Bradley-Burns tax, but that defense also fails. After California's enactment of the Uniform Commercial Code in 1963, RTC Section 6010.5 was adopted in 1965 to establish a "geographic-passage-of-title" rule based on physical location of the property at the time of the sale for the state sales tax, because there was concern that in-state transactions might be exempted by passing ownership via a transfer of documents of title outside California under the newly enacted CUCC. This problem

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[2] These efforts also failed for state tax purposes, because they were not grounded on any related statutory change and were contrary to RTC Section 6091 which places the burden of proof on the taxpayer to prove that state sales tax does not apply. (See, Diebold v. State Board of Equalization, supra, p.2; CUCC section 2401, which went into effect in 1965, is also contrary to the sweeping change reflected in Regulation subdivision 1628 (b) (3) (D), because it permits passage of bare legal title without ownership to be used as a regulatory test in certain areas of "public law," only where such had previously been the case. However, it was not until 1971 that subdivision 1628 (b) (3) (D) separated ownership from passage of legal title in a manner not contemplated by the CUCC and not permissible under the parallel definitions of "sale" contained in CUCC section 2106 and RTC section 6006 (a).

was addressed in RTC section 6010.5 by stating that sales occurred for state sales tax purposes where the property was located at the time ownership passed. This provision expressly excluded both "Parts 1.5 and 1.6," the Bradley-Burns and the Transactions Tax statutes from it with the approval of the State Board of Equalization.[3] Therefore, it is clear that the Board must have been administering the Bradley-Burns sales tax in 1965 on the understanding that the place where ownership or "title" transferred was irrelevant. (See legislative history of RTC Section 6010.5 attached as Exhibit C-1 through C-3.)

That was what Regulation 2202 (a) stated (See Exhibit A-1), and when Regulation 2028 was renumbered and revised in 1971, (See Exhibit A-6), subdivision 1628 (b) (4) also stated that the place where title passed was irrelevant to the Bradley-Burns sales tax.

In fact this understanding was entirely consistent with the language of both Regulations 2202 and 2203, as they were originally adopted in 1956 and remained essentially unchanged until 1970. (See Exhibits A-1, A-2, A-8, and A-9.)

Board Staff's Allegations Rebutted

The Board's Second Discussion Paper contains several allegations that are incorrect and require rebuttal. The rebuttals are as follows:

1. Present Regulation 1803 is incorrect in requiring the Bradley-Burns use tax to apply if the State use tax applies. The County and City ordinances are independent of the State sales and use tax statute, and the Bradley-Burns statute specifically excludes the State use tax statute. (See RTC subsection 7203 (e).) The county and the city use tax provisions also contain exemptions from the use tax if the local sales tax applies. See RTC subsections 7202 (h) (5) and 7203 (c). Therefore, the Bradley-Burns sales tax must be applied first to determine whether it applies. If it does, the local use tax cannot apply.

2. The case law regarding where a sale occurs for state tax purposes and Regulation 2028 (renumbered Regulation 1628 in 1971) support MSLLC's interpretation that the type of transactions at issue in this proceeding were normally treated as subject to sales tax by the Board's regulations during the 16-year period from 1956 through 1971, unless the taxpayer could provide, first detailed proof, and later "clear and convincing" evidence to the contrary. (See Exhibits A-4 through A-6.)

3. In interpreting whether the Bradley-Burns sales tax applies, the local ordinances and the Bradley-Burns statute govern. There is no statutory

[3] RTC Section 6010.5 reads as follows:

> "**Place of Sale.** For the purposes *of this part* [1], the place of the sale or purchase of tangible personal property is the place where the property is physically located at the time the act constituting the sale or purchase, *as defined in this part* [1] takes place." [Italics supplied.]

language that requires the state sales tax to govern whether the Bradley-Burns sales tax applies, and there is both statutory and regulatory language that exempts Bradley-Burns from the "place of sale" rules for State sales tax. (See, RTC Section 6010.5 and Regulation 1628 (b) (4).)

4. The provisions of Regulation 1628 (b) (3) are applicable in determining whether transportation charges are taxable for both state and Bradley-Burns sales taxes, because RTC Section 7205 provides that the state treatment of such charges will govern for Bradley-Burns purposes. The policy behind this rule was that the principal sponsors of Bradley-Burns wanted the local tax base to match the state base exactly in order to reduce the local tax compliance difficulties retailers had experienced with the diverse rates and exemptions of the pre-Bradley-Burns city ordinances.

5. The proposed clarifications for Regulations 1802 and 1803 would not require the retailers to address compliance issues that they do not already face. Their submission suggests, that a few may not now be complying with the current origin-based Bradley-Burns sales tax, even for transactions that transfer ownership in California.

6. The specific revenue losses anticipated by CSAC are based on a flawed 1996 study of that issue by Board Staff. The notion that the City of Los Angeles would lose approximately $ 1 MM of revenue from the proposed changes is ludicrous. That study also does not take into account the county one-quarter percent tax which is the principal source of Bradley-Burns revenue for counties. Therefore, its specific "winners and losers" predictions are misleading and should be ignored. The counties were also badly misled in 1996 on this issue, because they opposed the settlement proposal before the Business Taxes Committee at that time under the misapprehension that counties as a whole would be substantial net losers under it. That cannot be correct.

7. Staff should assess the potential impacts of the proposed changes in conjunction with qualified representatives of local government. Management of the necessary corrections of all past misallocations that are still pending and the transition to applying the Bradley-Burns statute and ordinances to this type of transaction should be conducted separately from this regulatory proceeding and in a fair, efficient and equitable manner that reflects the Board's obligations under the Bradley-Burns contract and RTC Sections 7209 and 7204. The only corrections necessary to consider concurrently with this proceeding are limited to those that would be required to dispose of the ruling in Cities of Los Angeles and San Jose that was taken under submission pending this regulatory proceeding.

The Proposed Amendments

The proposed amendments to both Regulations 1802 and 1803 are intended to conform them to the agreement reached in March of 1956 that if a local place of business "participated" in a sale by taking the order or negotiating the sale, a "conclusive presumption" would be apply that the sale occurred there. The only exception was to be that the state rule governing where a sale occurs for transportation charge inclusion purposes would also apply in calculating Bradley-Burns taxes, as required by RTC Section 7205 (a). This treatment was then provided in Regulation 2203 (now Regulation 1803, as renumbered and revised in 1970.) The proposal for Regulation 1802 (a) (3) eliminates only the wording that added an in-state-title-passage test that was contrary to RTC Section 7202 and the local ordinances which do not incorporate the "in this state" language that appears in RTC Section 6051, the state sales tax statute.

At the second interested party meeting, Board Staff suggested only that: i.) the current definition of "participation" used in practice be made more specific in the regulation draft to prevent insubstantial activities from meeting that definition; and ii.) leasing transactions be excluded from being affected one way or the other by these clarifications. Language and a transition rule have been added to the clarifying amendments provided in Exhibit D as suggested by Staff.

Technical Discussion

1. Sales Tax General Bulletin 52-5

   The express language of the Bulletin reflects that the purpose of the ruling was to apply the geographic title passage test to define the "in this state" requirement of the state sales tax contained in RTC section 6051. Neither Ruling 55 nor Regulation 2015 was revised in light of the ruling, so it is incorrect to interpret it as applicable to the Bradley-Burns sales tax or for any purpose other than locating the place of sale for state sales tax purposes. By its own terms, the ruling has no relevance to how the Bradley-Burns sales tax applies, because there is no statutory requirement that the incidence of the state sales tax also govern for Bradley-Burns sales tax purposes. In fact, Exhibit A-1 indicates clearly that Board Staff and the State Attorney General agreed in 1956 that the incidence of the local tax was "conclusively presumed" to be at the place of business where the sales activities were conducted.

   It is also very clear that a 1952 staff interpretation of Ruling 55 cannot alter the intent and meaning of the independent Bradley-Burns sales tax statute enacted three years later. Nor can it alter the "conclusive presumption" provided in RTC Section 7205, as reflected in the initial and later versions of

Regulation 2202 that participation in a sales tax transaction sources the local tax to the place of business where the participation occurs. That rule remained in effect, until Regulation section 2202 was amended in 1970 and renumbered as 1802, to include present subdivision (a) (3), which added an in-state title passage rule for the first time as a condition for applying the Bradley-Burns sales tax. There was no statutory authority to make that change, and therefore, it has always been invalid.

Ruling 55 (also known as Regulation 2015)

The 1956 cross-reference to "Ruling 55" or Regulation 2015 (not "2105" as stated) in subsection (a) of Regulation 2203) contains no reference to Sales Tax Bulletin 52-5 or to the "title" passage rule that Board Staff now claims to have been automatically incorporated under staff policy in Regulation 2015. If that had actually been the case, there would have been no reason to add the extensive references to title passage that appear in state sales tax regulations 1620 and 1628 (b) (3) (D) and in Bradley-Burns Regulation 1802 (a) (3) in 1970 and 1971.

The primary function of Ruling 55 and Regulation 2015 was how the federal constitution's negative ("dormant") commerce clause had been interpreted to apply to state and local sales taxes. These rules apply across-the-board to both state and local tax measures. Without another purpose in mind, there would have been no reason to add the cross reference to these authorities in Regulation 1803, because federal constitutional considerations will always be applicable to a local sales tax.

Therefore, the presence of language denying an explicit title passage rule in Regulation 2015 was probably the reason for the cross reference. Subdivision A. 2. (a) (1) thereof indicates unambiguously that the state sales tax applies to transactions of the sort involved here. No reference to passage of title appears in the body of the regulation at all, because the possible constitutional significance of such a rule had been removed by the decision of the U. S. Supreme Court in Norton Co. v. Dep't of Revenue of the State of Ill. (1950) 340 U. S. 534. That opinion permitted Illinois to impose its privilege tax on conducting sales activities at a permanent place of business in the state, even though ownership or title to the goods sold usually passed on shipment from Illinois. Thus, the U. S. Supreme Court's ruling in Norton directly supports the appealing cities' position in this proceeding.

We must also bear in mind that no geographic title passage rule had been included in the sourcing rules adopted in Regulation 2202 some six weeks earlier, and that the general rule is that regulations adopted contemporaneously are to be harmonized to the extent possible, in interpreting their meaning. As indicated previously, inclusion of a title passage test in

Regulation 2203 may also have been intended only to supply technical regulatory support for the statutory requirement in RTC Section 7205 (a) that the treatment of freight charges for state purposes control those for Bradley-Burns purposes.

2. The Diebold Case.

The leading California precedent on place of sale is Diebold, supra, , which is cited as authoritative in the Board's Business Taxes Guide, v. 1, p.1078 (2004-1) under RTC Section 6051. Board Legal Staff has claimed to rely on that case for years in interpreting when and where the Bradley-Burns sales tax applies. It applies a facts and circumstances approach based un the underlying commercial law governing where a sale is completed.

Nonetheless, Staff has carefully avoided any detailed discussion of that opinion in both Discussion Papers because it clearly does not support the "bright-line' test they seek to apply to Bradley-Burns sales under CUCC subdivisions 2401 (1)-(4), as interpreted by Regulation 1628 (b) (3) (D).

The facts in Diebold were similar to those in Cities of Los Angeles and San Jose in that the Taxpayer had permanent places of business in California that originated sales to California purchasers that were fulfilled by shipment directly to the purchasers. Although the case was decided after Bradley-Burns was adopted, the periods involved appear to have preceded April 1, 1956 when it went into effect. The opinion never mentions city sales taxes and analyzes the transactions at issue based upon the terms of the governing contracts or invoices and related facts. One set, the so-called "bank agreements," was determined to constitute "delivery" contracts under the USA, Civ. Code Section 1739 (5), only because they provided, inter alia, that the retailer was to pay the shipping costs. Another set of three contracts was determined to transfer ownership of the property outside California, because they indicated that "title" was to pass upon shipment from Ohio and the USA, Civ. Code Section 1739 equated that term with the "property" meaning full ownership. It was held that the sales tax could not be applied to these sales, presumably because they did not occur "in this state" under RTC Section 6051, and the use tax was not at issue.

The third set of agreements provided that the Taxpayer retained "title" as security until payment in full had been received, and the facts indicated that installments remained to be paid after delivery had occurred in California. These transactions were held to be subject to the sales tax because the Court determined that possession had transferred in California, not upon shipment in Ohio. RTC Section 6006 (e) still states that such transfers of "possession"

constitute taxable "sales" for California sales tax purposes, but Board Staff refuses to recognize this statutory rule.[4]

Thus, Diebold, the leading California opinion for applying the state sales tax to shipments from out of state, conducted a detailed analysis of the contracts and the underlying commercial law to determine where "property" or ownership of the property transferred. Certain contracts were construed to constitute "delivery" contracts, even though they didn't say so in so many words or contain any "FOB" terminology, because the taxpayer was unable to satisfy its burden of proof that the sales tax did not apply.

Therefore the basic methodology used in Diebold is still good law. The only change mandated by the CUCC is that now the analysis must be performed under the revolutionary revisions of sales law contained in Division 2 to determine when the sale process has progressed to a point where it may be concluded legally that the purchaser has become the owner of the property and the seller is entitled to receive or retain payment. Under both the CUCC and, as exemplified in Diebold the prior USA, this analysis is to be performed on a step-by-step basis, at least for California state sales tax purposes. There is no California case law that holds the Legal Staff's "bright-line test" under CUCC Section 2401 (2) governs characterization of the state sales tax.

3. Relationship of Regulation 1628 and Regulation 1803.

The statement of substantive law quoted from Ruling 58 in the Second Discussion Paper seems to be in general agreement with the 1961 version of Ruling 2028, (Exhibit A-4) which deals with the same subject. However, the latter does not mention Ruling 58 and therefore appears to have superseded it. The principal difference between "Ruling 58" as quoted and the 1961 version of Regulation 2028, as set forth in the 1961 version, may simply be that the latter stated clearly and extensively that the taxpayer had the burden to prove where the sale occurred for purposes of determining whether it took place before the freight charges had been incurred so that they could be excluded from the tax base, or after, in which event they could not.. The California Supreme Court's 1959 ruling in Select Base Materials v. State Board of Equalization (1959) 51 C. 2d 640, 645 confirmed that delivery or freight charges would often have to be subject to tax if the sale occurred after delivery

[4] A similar transfer-of-possession rule applies under the definition of taxable "sale" contained in RTC Section 6006 (f) for transfers of "title or possession of tangible personal property which has been produced, fabricated, or printed to the special order of the customer, or of any publication." Both provisions defining transfers of "possession or title" as "sales" under RTC Section 6006 (e) and (f) are inconsistent with the Staff's current "bright-line test" under CUCC Section 2401 (1)-(4), because that test fails to recognize transfers of possession as taxable "sales" and is not based on when and where ownership passes for general commercial law purposes. Allocation appeals involving both RTC subdivisions 6006 (e) and (f) are pending.

to the purchaser. Diebold recognized that the taxpayer has the burden of proof that the sales tax does not apply after delivery.

To the extent that Regulation 1802 recognizes that "participation" in sales activity is central to determining where a sale occurs, it is entirely consistent with RTC section 7202 which imposes the Bradley-Burns sales tax on exercising "the privilege of making sales at retail." Without "participation" as specified in Regulation 1802 (a), there can be no exercise of the activity on which RTC Section 7202 imposes the tax.

It is incorrect for the Second Discussion Paper to assert, at page 8, that the place where title or ownership passes for purposes of Regulation 1620 and 1628 is also relevant for purposes of Regulations 1802 and 1803, except to the extent that the "freight charges" rule of RTC Section 7205 (a) ties their treatment for Bradley-Burns purposes to the state rule. Nor should it be overlooked that RTC Section 6010.5 states that placement of the sale at the physical location of the property when the sale occurs does not apply to Part 1.5, Bradley-Burns, but only to Part 1, the state sales and use tax.

RTC Section 6010.5 is the statute that Regulation 1628 (b) (4) is based on, and it was adopted in 1965, nine years after Bradley-Burns went into effect in 1956 and six years before the renumbering and revision of Regulations 2015, 2202, 2203, 2028 had been completed.

4. Relationship of Regulation 1802 ("Place of Sale and Use, etc.") and Regulation 1803 ("Application of Tax.)"

Assuming (without conceding) that the Second Discussion Paper is correct in claiming that that only Regulation 1803 (and its predecessor, Regulation 2203) and not 1802 (and its predecessor Regulation 2202) interprets RTC Sections 7202, and 7203 then it has been invalid since adoption in 1956. This is because it fails to accurately reflect the provisions of those sections.

The ordering rule implicit in both the state and the local sales and use taxes is that applicability of the sales tax is always to be considered before applicability of the use tax. RTC Section 6401, and subdivisions (h) (5) of RTC section 7202 and (c) of 7203 all state that transactions are exempt from the use tax under both statutes if the sales tax applies. This is to be expected, because the use tax is supposed to "back up" and be complementary to the sales tax. Another way of saying this is that if the sales tax applies, there is no need for a use tax and it does not and cannot apply. This firm rule is not reflected anywhere in present Regulation 1803.

Nor is there any statutory support for the rule stated in Regulation 1803 that the Bradley-Burns use tax must apply if the state use tax does. In fact TRC

section 7203 has always expressly excluded the basic state use tax statute, RTC Section 6201, from being incorporated by reference in Bradley-Burns. Thus it is clear that the Bradley-Burns use tax applies only on its own terms and was never intended by the Legislature to be governed by state rules.

6. Issuance of a Seller's Permit

The type of permit issued for a place of business cannot alone determine the character of the local tax, because the internal administrative policies governing issuance of permits are not necessarily reflective of statutory requirements regarding which type of tax applies. Also, the first sentence in the second paragraph of this section on page 9 of the Second Discussion Paper is incorrect to the extent it implies that negotiating, conducting or managing the sale process is not sufficient to attract a retail seller's permit. (See the broad language requiring registration of "each place of business in this state at which transactions relating to sales are customarily negotiated . . . ." Regulation 1699 (a).)

7. Receipt of Schedules by Out-of-State Sellers.

Again, although the schedules issued to retailers subject to the sales tax should accommodate its accurate reporting, they are strictly administrative and cannot alter the statutory nature of the tax.

8. When May Local Tax Revenues Be Reallocated?

To the extent that the Board Members have discretion under RTC Section 7209 to correct incorrect distributions, it should consider exercising that discretion to make correction in light of the agreed facts in Cities of Los Angeles and San Jose and the lack of any statutory support for treating the transactions at issue as subject to Bradley-Burns sales taxes.

Resolution of other pending cases, including the several categories of "Mass Appeal" cases outlined in the Board Staff's First Discussion Paper should await a more accurate estimate of the gross and net amounts of the actual corrections that would be required and how to make them as creatively and equitably as possible. The Board should recognize that, as the Bradley-Burns contractual agent to collect and distribute sales and use tax revenues of all cities and counties in California, it has an obligation to perform them, including those arising under RTC Sections 7204 and 7209, as fully and equitably as possible.

9. LAO Report.

The LAO Report does not mention the type of transaction involved in this Interested Party Proceeding as being particularly vulnerable to the rebate contracts described in it. In fact, to MSLLC's knowledge, none of the pending Mass Appeal or other claims of the type involved here, including those arising in Cities of Los Angeles and San Jose, have rebate agreements in place.

The expansion of the annual volume of transactions subject to the sales tax as opposed to the use tax is expected to be minimal, in any event. The amounts at issue in Cities of Los Angeles and San Jose are relatively modest.

MSLLC also believes that the 1996 Board study is not a reliable basis for calculating the net amounts at issue under the Mass Appeal and related cases that are still pending Board hearing. The net aggregate adjustment to county pools predicted by the 1996 BOE study was approximately $ 13.4 MM per annum. Many of the 895 claims studied at that time involved taxpayers that are no longer operating in the claiming jurisdictions and for which no replacement claims have ever been filed. MSLLC's records indicate that only approximately 100 of those businesses are operating in those locations today.

Thus, severe erosion of the original number of continuing claims has occurred over the intervening 12 years since the figures used in that study were gathered, and therefore it would be very misleading and highly inaccurate to multiply the $ 13.4 MM times 12 to calculate a net estimated correction amount under current conditions. [5]

10. Direct Impact on Retailers.

a. Retroactivity

First, it should be recognized that the liability of retailers affected by the clarified regulations would not be greater than they now have, because, by definition, all of them have places of business in California and are therefore liable to collect and remit the use tax under the current Board policies regarding this type of sale. The extent to which Board Staff would be required to make overly intrusive

[5] We also note that even the $ 13.4 MM estimated annual correction amount was only approximately 4.5 % of the aggregate estimated county pool amount of $ 300 MM for the 1994-95 period. (See BOE Annual Report 1994-95, Table 20. The ten percent pool estimate is from other Board estimates. See First Discussion Paper Regulation 1802 (d) (1), dated January 20, 2007. Since all the claims studied in 1996 are no longer currently valid and have been eroding constantly since 1996, their continuing percentage of the aggregate annual pools would likely be much less than the 4 to 5 percent estimated for 1994-95.

inquiries regarding old returns that Board Staff may have allowed to be destroyed is also a matter for careful consideration.

b. State Variations

It is incorrect that "every other state in the country" taxes this type of transaction in accordance with the method that California has imposed since 1971.[6] Secondly, local taxes are often sourced to the place of negotiation in order to protect local revenues.[7] In any event, the increase in complexity of the California sales and transactions tax systems would be marginal only, certainly not enough to cause it to burden interstate commerce unreasonably, especially since all the taxpayers involved are understood to have physical nexus in the state.

The complaint that some software systems do not accommodate sourcing local tax allocations and rates based on the place of negotiations, as required for all Bradley-Burns sales taxes whether shipment is from out of state or in-state, creates an inference that some retailers may be misallocating Bradley-Burns revenues. That is why jurisdictions retain consultants and Board Staff conducts periodic audits. If the shipment is from an in-state warehouse, allocation to the place of sale negotiation is mandatory. Furthermore, both retailers and Board auditors have devised sampling methods for locating sales of-multiple location sellers that have been used for years with general acceptance by both Board Staff and local jurisdictions alike.

Also, sourcing all local taxes, including both Bradley-Burns and the District or Transactions tax on a destination basis, for both in-state and out-of-state shipments is incorrect and suggests that any taxpayer that does so may be both overpaying and underpaying its transactions tax liability while misallocating local taxes at the same time.

c. Transaction and Rate Tracking and Collection and Reporting Duties of Retailers.

[6] See, e.g., Matrix Funding Corp. v. Utah State Tax Commission (2002) 52 P. 3d 1282, 2002 UT 85; A. D. Store Co., Inc. v. Executive Director of the Department of Revenue of the State of Colorado (2001) 19 P. 3d 680, 2001 CJ C. A. R. 557; Commonwealth of Virginia Department of Taxation v. Blanks Oil Co. (1998) 255 Va. 242, 498 S. E. 2d 914; New England Yacht Sales, Inc. v. Commissioner of Revenue Services (1986) 198 Conn. 624, 504 A. 2d 506; Department of Revenue, Commonwealth of Kentucky v. Cox Machinery Co. (1982) 650 S.W. 2d 261; In Re Pacific Express, Inc. (1986) 780 F. 2d 1482 (California); Fuchs Agency Inc. v. Wisconsin Department of Revenue (1979) 91 Wis.2d 283, 282 N. W. 2d 6.

[7] See Virginia v. Blanks Oil Co. (1998) 255 VA. 242 (Tax Statute fixing place of business as place of sale for local tax purposes prevailed over argument based on commercial law that sale occurred on delivery.)

The difficulty of determining the proper aggregate tax rate is not a Bradley-Burns issue, because that rate has always been uniform from county to county and for cities within the counties, whether the applicable tax is use or sales tax. In either event, it cannot exceed 1 ¼ percent (or 1 percent under the triple flip in which ¼ was traded for property tax revenues to be distributed later.) Any rate problem can arise only under the Transactions Tax system imposed by Part 1.6 of the Revenue and Taxation Code, not 1.5, the Bradley-Burns tax which permits uniform rates only.

That system has produced a variety of rates in districts throughout California under the California Constitution which permits new taxes to be adopted by counties, cities and districts only after an affirmative vote of the people has occurred. In addition, the limits on the actual rate can vary from district to district which does make for less uniformity.

To the extent this problem exists today, sourcing both the Bradley-Burns and the District taxes on a destination basis is incorrect if the Bradley-Burns sales tax applies even if the purchaser takes delivery outside the jurisdiction where negotiation occurred. Under current law, if the sales tax applies, and the retailer has nexus in the Transactions Tax District, it will be required to collect and remit the District tax, while it may also be required to allocate Bradley-Burns sales tax to the jurisdiction where the sale was negotiated. The extent to which this problem would be increased by the proposed regulations is marginal, since the pooled revenues affected are expected not to exceed approximately 5 percent of the aggregate pooled annual revenues of approximately $ 500 MM, and many of the sales in question may not involve the sourcing issue.

11. Direct Impact on Local Jurisdictions

a. Use tax direct payment permits.

Although it is correct that Use Tax Direct Payment Permits will no longer be usable by local jurisdictions to allocate the local one percent tax from the subject transactions to the place of first use, such permits are not now applicable to sales tax transactions. To the extent local jurisdictions or taxpayers are concerned about this change, they may purchase directly from out-of-state retailers rather than locally, in which event the local use tax would still apply and be subject to the exemption and self-reporting alternative if there is no local participation in the delivery. Alternatively, they could purchase from a location in their city

and receive the resulting sales tax revenues automatically without having to resort to a use tax exemption certificate.

b. Budgetary Concerns.

MSLLC acknowledges that local jurisdiction budgetary concerns must be taken into account in the transition to imposing Bradley-Burns sales tax on the subject transactions. Liberal mitigation rules must be provided to bridge the transition, and Board Staff and the claiming jurisdictions should cooperate to establish accurate estimates of the effects that can be anticipated both retroactively and prospectively.

Board Staff has the best records to carry this work out, and approximately a year ago MSLLC was informed by the Appeals Division that the necessary information would be developed by the Sales and Use Tax Department. That work has still not been accomplished because of illness in the Department, but it should now be reassigned for priority completion during the month of April and well in time for inclusion in the Department's final Discussion Paper for consideration by interested parties and Board Members during May and prior to the May 21, 2007 issuance of the Final Discussion Paper as indicated on page 17 of the Second Discussion Paper. If the 1996 estimate cannot be refreshed and brought current in time for careful verification and review prior to the May 31 Business Taxes Committee meeting, MSLLC requests that meeting be limited to considering the regulation clarifications and final disposition of the Cities of Los Angeles and San Jose appeal.

c. Mass Appeal

The Board Staff's estimate of 1350 pending claims under the Mass Appeal is overstated by approximately 400 claims. Probably this has occurred as a result of double-counting some appeals that were filed prior to 1995 and then recounting the same appeals when they were refiled in late 1995 in preparation for the proposed settlement of the issue that was never completed. The precise number of claims is less important, however, than determining the revenues that could be affected from the correction process.

The internal study done by Staff in 1996 appears to be flawed in its attempt to determine the "winners and the losers" from correction and the data on which it is based and all the assumptions supporting it have never been revealed publicly. Nor has that study ever been represented as being statistically sound. Therefore, that study should not be regarded as authoritative in establishing the list of "winners and losers" as

provided as Exhibit 7 to the Second Discussion Paper. That cannot be responsible prediction.

12. Allocation Group and LRAU Staff Costs.

MSLLC questions the estimate of 1250 new inquiries per annum on this issue once the regulations have been clarified. Awaiting some experience before budgeting for such an increase in total workload would appear prudent. ALSO, MOST OF THE NEW INQUIRIES OF THIS NATURE WILL NO LONGER REQUIRE THE ENDLESS FACTUAL INVESTIGATIONS AND RESULTING INACCURACIES FOR UNINVESTIGATED TYPES OF CONTRACTS OF THE SAME TAXPAYER THAT EXISTS UNDER THE CURRENT FACTS AND CIRCUMSTANCES POLICY. Even if a number of new submissions were to materialize, the time required to investigate each should be radically reduced.

The Correction Process

Near the close of the Second Interested Party Meeting, Board Staff urged that the supporters of the clarifications to Regulations 1802 (a) (3) and1803 include in this submission a description of how the existing 900-odd pending inquiries should be corrected once the revisions are adopted. We were surprised by that suggestion because it had not occurred to us that the substantive issues addressed in the regulations process would be affected by the amount of corrections required. In the past, almost all distribution corrections have been handled routinely by Board Staff, based on the best information available, without substantial in-put from MSLLC and, over almost thirty years, no continuing disagreements over amounts.

Approximately a year ago, the Legal Department and the Allocation Group of the Refund Section had indicated that, with rehearing under consideration in Cities of Los Angeles and San Jose, the Sales and Use Tax Department would be required to produce a study of the revenue impacts of correction of the Mass Appeals, and MSLLC offered to cooperate in that process. This work has still not been done, however.

Nevertheless, MSLLC intends to cooperate fully with Staff's request, because correction is vital to the integrity of the entire Bradley-Burns allocation system and needs to be addressed comprehensively in these cases in order to avoid unintended consequences. However, any such advice or assistance MSLLC provides to Board Staff should be understood only as its attempt to comply with this request for assistance from Staff, and not as a fixed position or offer, either by MSLLC or any local jurisdiction, whether a "winner" or a "loser".

MSLLC believes that the re-distributions required in this situation can be made if the concerned local and state agencies recognize the need for reasonable flexibility in approaching and solving the problem of how to provide redress for thirty-five years of illegal distributions.

There are many facts unknown to both MSLLC and the claiming cities that must be gathered and weighed before any kind of understanding can be reached as to how the corrections should be managed. MSLLC is committed to negotiating a reasonable correction process with Board Staff to establish a practical approach that will recommend itself for consideration by affected jurisdictions.

MSLLC approaches the necessary corrections in this matter with great care, because the breadth of the company's clientele will result in some suffering negative consequences from the corrections, though in relatively small amounts, as well as those that may benefit. This distinguishes MSLLC from other consultants or the internal staffs of local jurisdictions that chose not to file any claims relating to this issue, even after the dispute became public in 1996. Therefore, MSLLC must take as objective a position as possible on corrections, because that is what our clients expect and deserve. In this, Board Staff may discern a common interest with that of MSLLC.

In the cases under consideration, our position is based on the original Bradley-Burns statute and how it was interpreted in the contemporaneous 1956 regulations until 1971. That is the objective reality we respect. We are also mindful that Board Members are provided a degree of discretion under RTC Section 7209 in making corrections, and we suggest that it would be wise to consider maximum reasonable mitigation to jurisdictions that would experience budgetary hardship as a result of the final corrections ordered.

We counsel that the impact of any such hardship might be controlled by stretching out any net redistribution charge from a jurisdiction over a period of at least 12 calendar quarters. The charge for any quarter should not exceed a ceiling of five percent of the average total pool amount for the preceding 12 quarters, plus 100 percent of the growth above that average for the current quarter. If the ceiling or cap became effective, corrections would continue to be made from the jurisdiction's pool until the jurisdiction's net redistribution charge was exhausted.

In order to begin the correction process, we have contacted Board Staff to request a meeting to address the following matters:

1. Agreement that purpose of meeting is to work-out an overall reasonable plan to resolve the Mass Appeal Claims. MSLLC proposes that the objectives of the plan be to establish, based on the best historical and statistical information available:

    a. A gross estimated correction amount for each claim;

b. An estimated "pool adjustment" amount for each claim to reflect any revenues originally distributed to the claimant with respect to transactions reflected in such claim;

c. The amount determined by deducting the b. amount (estimated "pool adjustment") from the gross estimated correction in a, to be distributed to the claiming jurisdiction as the "estimated net correction;"

d. A method for charging the estimated net correction to the pools of other counties..

2. Standardization of lists of Mass Appeal claims for comparison purposes.

3. Provision of all work-papers and audit assumptions and criteria used by Board Staff in compiling the 1996 estimate of audited and unaudited gross and net corrections that would be required for the 895 claims reviewed at that time.

4. Provision of all available pool, payment and file data relating to each Mass Appeal claim.

5. Development of a work-plan for Board Staff to review all outstanding claims involving this issue for approximately 100 taxpayer places of business that remain open and provide tentative actual net correction amounts and pool charges.

6. Development of a joint work-plan for reviewing and quantifying net corrections and charges with respect to retailers no longer located in the claiming jurisdiction.

We look forward to completing this process as rapidly as possible so that it may be carried out and managed objectively and professionally.

Yours very truly

Albin C. Koch/ct

Albin C. Koch
Special Tax Counsel
MuniServices LLC

CC: All Board Members and Staff
Randy Dryden
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April 6, 2007

Mr. Jeffrey McGuire
Tax Policy Manger, MIC: 92
Sales and Use Tax Department
PO Box 942879
Sacramento, CA 94729-0092

RE: PROPOSED AMENDMENTS TO BOARD OF EQUALIZATION REGULATIONS 1802 AND 1803

Dear Mr. McGuire:

I write to inform you that the League of California Cities Revenue and Taxation Policy Committee (Committee) has taken a position on the proposed amendments to Regulations 1802 and 1803 as discussed in the second issue paper released by BOE staff. The Committee's unanimous recommendation has been placed on the League's Board of Directors consent calendar agenda for final action and adoption at the next Board meeting, which is scheduled for mid-May.

The League's Revenue and Taxation Committee supports the proposed amendments to Regulation 1802 and 1803 on a prospective basis. The Committee supported this approach as a way to implement the League's existing policy, which favors situs-based allocation as the appropriate method to match local revenues with the local impact.

However, the Committee did not take a position on application of the amendments to existing claims on a retroactive basis. During the Committee meeting, many questions arose as to what the financial impact of retroactivity would be on California cities and how to enact a reasonable reallocation method. The Committee felt that without this important information on the fiscal impact, no position on retroactivity could be taken.

The League requests that Board staff undertake an analysis showing the amount of money to be reallocated and the number of jurisdictions affected by these proposed amendments. We believe that this analysis should be shared with all interested parties for their feedback no later than a few weeks prior to the Business Taxes Meeting to be held on May 31, 2007, and certainly prior to any decision by the BOE on the issue of retroactivity.

Should you have any questions about the Committee's position, please feel free to contact me at (916) 658-8222.

Sincerely,

Daniel Carrigg
Legislative Director,
League of California Cities

cc: The Honorable Betty Yee, Chair, State Board of Equalization
The Honorable Judy Chu, Vice-Chair, State Board of Equalization
The Honorable Michelle Steel, Member, State Board of Equalization
The Honorable Bill Leonard, Member, State Board of Equalization
The Honorable John Chiang, State Controller, Ex-Officio Member, State Board of Equalization

An Illustration – Reallocation of 2nd Qtr. 1995 County and State Pool Amounts For The 2 Largest "Winners" and 2 Largest "Losers" for each Equalization District

(Based on 1996 Impact Study)

	(A)	(B)	**(C)**	(D)	(E)	(F)	**(G)**
Jurisdiction	Actual 2nd Qtr. 1995 Pool % (rounded up)	2nd Qtr. 1995 Pool Losses Per County (1996 Study)	2nd Qtr. 1995 Countywide Pool Loss[1] per Jurisdiction **(A)*(B)**	Actual 2nd Qtr. 1995 Statewide Pool % (rounded up)	2nd Qtr. 1995 Statewide Pool Loss[2] per Jurisdiction	2nd Qtr 1995 Gains Through Direct Allocation	2nd Qtr. 1995 Net Gain or Loss to Jurisdiction **(C)+(E)+(F)**
DISTRICT 1							
SAN RAMON	7.34%	($162,690)	($11,941)	0.21%	($236)	$508,726	$496,549
SANTA CLARA	14.83%	($909,596)	($134,893)	1.10%	($1,237)	$373,210	$237,080
MOUNTAIN VIEW	7.64%	($909,596)	($69,493)	0.57%	($641)		($70,134)
SAN FRANCISCO	100%	($238,125)	($238,125)	3.08%	($3,463)	$33,900	($207,688)
DISTRICT 2							
TULARE	13.42%	($36,747)	($4,931)	0.12%	($135)	$79,327	$74,261
VENTURA	22.28%	($93,722)	($20,881)	0.46%	($517)	$80,578	$59,180
BAKERSFIELD	51.41%	($69,332)	($35,644)	0.90%	($1,012)	$1,279	($35,377)
ALTURAS	70.05%	($55,989)	($39,220)	0.02%	($22)		($39,242)
DISTRICT 3							
SAN DIEGO	50.04%	($421,594)	($210,966)	3.86%	($4,340)	$474,148	$258,842
CYPRESS	1.95%	($1,076,030)	($20,983)	0.20%	($225)	$161,698	$140,490
WESTMINSTER	2.88%	($1,076,030)	($30,990)	0.29%	($326)		($31,316)
BUENA PARK	3.06%	($1,076,030)	($32,926)	0.31%	($349)		($33,275)
DISTRICT 4							
IRVINE	9.64%	($1,076,030)	($103,729)	0.97%	($1,091)	$530,421	$425,601
EL SEGUNDO	0.48%	($1,793,109)	($8,607)	0.13%	($146)	$160,124	$151,371
LOS ANGELES CO UNINCORP	3.92%	($1,793,109)	($70,290)	1.04%	($1,169)	$640	($70,819)
LOS ANGELES	34.54%	($1,793,109)	($619,340)	9.20%	($10,345)	$371,802	($257,883)

[1] There are immaterial differences between the actual amounts calculated in the 1996 study for 2nd quarter 1995 and the amounts illustrated above due to rounding for illustration purposes.

[2] Second quarter 1995 Statewide Pool reduction (Loss) is **$112,446**.

An explanation of why some jurisdictions experienced a net loss under the 1996 Impact Study even though they may have experienced a gain through a direct reallocation
(As illustrated in the table)

County pool revenue is distributed based on the percentage of an individual jurisdiction's direct allocation as compared to the direct allocation for all other jurisdictions within the same county. Any losses to the county pools are distributed to each jurisdiction based on this same ratio.

State pool revenue is distributed based on the percentage of an individual jurisdiction's direct allocation *and* countywide pool distributions as compared to the direct allocation and countywide pool distributions for all other jurisdictions in the state. Any loss to the state pool is distributed based on the same ratio.

Under the proposed change, an individual jurisdiction's gain through a direct reallocation of revenues will be derived from losses to county pools inside and outside their county, as well as the losses to the state pool. As such, it is possible (even probable) that the pool losses distributed among the jurisdictions within each county will more than exceed the gains experienced by an individual jurisdiction under a reallocation.

As illustrated in the table, this would be the case for the losing jurisdictions. Although the jurisdictions experienced gains through a direct reallocation under the proposal, the gains were *not* sufficient to offset their county pool losses that resulted from the direct reallocations to other jurisdictions.

For example, the City of San Francisco receives **100%** of the San Francisco County Pool allocations. Under the study, the City was expected to gain **$33,900** through direct reallocations for 2nd quarter 1995. However, the county pool was expected to lose **$238,125** of revenue that would be reallocated to other jurisdictions, resulting in an expected net loss to the City of **$207,688,** which includes the City's portion of the state pool loss.

Although the City of San Francisco is unique because it is the only city deriving revenue from the county pool, the same type of loss would be experienced by other jurisdictions in other counties when gains experienced through a direct allocation are not sufficient to offset the jurisdiction's ratio of losses to their county pool.

For example, the City of Los Angeles was expected to experience a gain of **$371,802** for 2nd quarter 1995. However, since the City previously received **34.54%** of the Los Angeles County Pool allocations for the 2nd quarter *and* the pool was expected to lose **$1,793,109** due to the reallocation of pool revenues, the City's portion of the pool loss ends up exceeding the City's expected gain, resulting in a net loss for 2nd quarter 1995 (with the inclusion of the City's portion of the state pool loss) of **$257,883.**